

MERCANTILE LAW

Including Industrial Law

by

PROF. SOHRAB R. DAVAR



TWENTIETH EDITION

by

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DEDICATED

To

MY BELOVED STUDENTS

1741

Preface to the Twentieth Edition

This edition has been thoroughly revised and adapted to the syllabus requirements of various Universities and Professional Examinations. It is divided into three parts, *viz.*,

Part 1 — The Indian Contract Act

Part 2 — Partnership; Sale of Goods; Negotiable Instruments; Insurance — Life, Fire & Marine; Common Carriers; Mortgages and Charges; Insolvency Law; Arbitration; Trade Marks and Patents

Part 3 — Industrial Law

Latest amendments to the various Acts and relevant case laws have been embodied.

Four other separate volumes are also published simultaneously to suit the needs of students appearing for examinations conducted by various examining bodies. They are: (i) "Business Law" for B.Com., of Bombay University; (ii) "Commercial Law" for B.Com., of Madras, Bangalore and Mysore Universities; (iii) "Mercantile Law and Company Law" for I.C.W.A., students and (iv) "Mercantile Law" for C.A.I.I.B. and ~~D.Com. (I.M.C)~~ professional courses.

In order to help the students to learn effectively and as an aid to memory, important points have been emphasized in bold or in italic letters; there is a summary at the end of each chapter followed by typical examination questions and a detailed index of case law and text for ready reference.

Davar's College of Commerce

Bombay

January 5, 1981

KHORSHED D.P. MADON

Preface to the Eleventh Edition

The Eleventh Edition has also been revised as usual with a view to meet the requirements of the Syllabuses of Professional and University Examination as suggested by Examination papers and revised syllabuses. The Indian Insurance Act, 1938, has been dealt with in great detail. Common Carriers Law including Carriage by Land, Sea and Air has been dealt with in a separate chapter entitled "Common Carriers and Carriage of Goods by Land and Sea". The New Indian Arbitration Act of 1940 replaces the old; the Provincial Insolvency Act also forms part of the Chapter on "Insolvency Law", and a separate chapter deals with "Trade Mark, Designs, Patents and Copyrights". Industrial Law Chapter also includes Payment of Wages Act of 1936. The Stamp Law and the Law of Limitation have also been brought up-to-date.

The author takes this opportunity to thank the professors and teachers of the subject once again, for their kind appreciation of the utility of this little book and expresses his gratitude for the many useful suggestions received from them. The author also trusts that the same encouragement will continue from his colleagues in the professional line.

The author's thanks are also due to his daughter, Miss Khorshed S. Davar, LLB., Advocate (O.S.) and Finalist of the Chartered Institute of Secretaries (London), for assistance in the revision of this Edition and to his son, Rustom S. Davar, A.C.C.S. (London), for preparing the index.

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SOHRAB S. DAVAR

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Part 1

THE INDIAN CONTRACT ACT

Chapter 1

SOURCES OF MERCANTILE LAW

What is 'Law' ?

THE TERM 'Law' is used in different senses. In the physical and natural sciences law is understood in the sense of an observed uniformity in nature, for example, the Law of Gravity. In the practical and moral sciences, the expression 'Law' is used in the sense of a rule of external human action, for example, etiquette, fashion, etc., where the observance of the rule is enforced by the fear of public opinion.

In its widest sense, the term law is used to mean any rule of action, standard, or pattern to which actions are required to conform.

"Law in its most general and comprehensive sense signifies a rule of action and is applied indiscriminately to all kinds of action, whether animate or inanimate, rational or irrational".

Blackstone

The term 'Law' in its narrow or popular sense is applied to the rules of human behaviour recognised and enforced by the state through its courts.

“The law of the state or of any organised body of men composed of the rules which the courts—that is the Judicial organs of that body—lay down for the determination of legal rights and duties”.

Gray

In each of the many senses in which the term ‘law’ can be applied two common factors exist:

- (1) a set pattern and-
- (2) fear of the consequences which results in the observance of the set pattern, or what is known as ‘sanction’.

Thus the rules of etiquette are observed through the fear of public ridicule, the law of the land is observed through the fear of arrest, imprisonment, fine, etc., and the rules of international law, through the fear of war.

Classification of Law

Law may be classified broadly into

1. public law and
2. private law.

Public law deals with the constitutional and administrative powers of the state and also with certain relations between the state and the individual.

Private Law deals with the rights of the subjects *inter se* i.e. between or among themselves. Private law may be further subdivided into (a) substantive law and (b) adjective law. Substantive law deals with rights which may be acquired by one citizen against another, for example, the law of property contracts, torts, etc. while adjective law deals with the procedural matters or the machinery by which rights can be enforced in a court of law, for example, the Civil Procedure Code and the Criminal Procedure Code.

The Object of Law

The object of law is the creation and protection of legal rights. A legal right has been defined by Holland as the ‘capacity residing in one person of controlling with the assent and assistance of the state, the actions of others’. There can be no rights without corresponding duties.

Right in rem and Right in personam

Rights may be classified into rights *in rem* and rights *in personam*.

A right *in rem* is a right which is available against the whole world. For example, if a man owns a piece of land the right which he has in that land casts a duty on the whole world not to disturb his ownership in any way. The same applies to the right to freedom, reputation, etc.

A right *in personam* is a mere personal right for which the corresponding duty is that of an individual or a definite body of individuals. For example, in the case of a breach of contract to sell land, the right of the aggrieved party is only a personal right to sue the other party to the contract and not a right in the land itself.

Knowledge of Law

Although it is not possible for a person to know all the law of his own country he will not be excused on the ground of ignorance of law because it would be very difficult, if not impossible, to prove such ignorance for "the devil himself knoweth not the mind of man". For purposes of expediency, therefore, the maxim "*Ignorantia juris non excusat*" or "ignorance of law is not excused" is applied by the Courts. It is therefore essential for everyone to know the general principles of the law of his own country, and more particularly those branches of law which apply to his particular branch of work. For example, businessmen need to be familiar with mercantile law in order to avoid the pitfalls into which they may fall through ignorance.

Mercantile Law

Mercantile Law means that branch of Law which is applicable to concerned with trade and commerce in connection with various mercantile or business transactions. Some authors define it as a branch of Law concerned with business, trade and commerce. A good portion of this branch of Law arises from the practices and usages of the mercantile community, as we shall see later in this chapter.

Sources of Indian Mercantile Law

Indian Mercantile Law is based on English Mercantile law modified to suit Indian conditions. It is incorporated in a number of Indian Acts and enactments which mostly follow the English Law on the subject with some important modifications.

The sources of English Mercantile law are:

- (1) Common Law
- (2) Equity
- (3) Statute Law
- (4) Lex mercatoria or the Law Merchant and
- (5) Roman Law.

1. **Common Law** : Common Law is the oldest “*unwritten*” law and was formerly administered in England in the Court of the King’s Bench; the Court of Common Pleas and the Court of Exchequer. It is called “*unwritten*” because it is not written in any enactments or statutes but is to be found only in ancient treatises and in the decisions of judges scattered in law reports. This law was based upon customs and practices handed down from generation to generation. This consolidation came about as some of the judges appointed by the King at Westminster began to travel through the country in what are now called circuits in order to hold courts from place to place, hear cases and administer justice. As these visits became frequent the local courts gradually began to lose their importance, declined and ultimately disappeared with the result that the law enforced at Westminster became the law of the whole country.

The law which thus grows on the decisions of the judges both in connection with the Common Law or any other branch of law is called “*Case Law*”. This Case Law is binding on all Courts having jurisdiction inferior to that of the Court which gave the judgment, and even in the case of those of equal jurisdiction, the usual and universal practice, with rare exceptions, is to follow the earlier decisions which have been time honoured and are of long standing.

2. **Equity** : Equity grew up latter as compared with Common Law. Common Law did not provide for various transactions such as trusts, mortgages, partnerships, etc. and these points gradually came to be taken up by the Lord Chancellor who established various rules based upon reason and natural right, *i.e.* equity, which grew up into a system. Later on *Courts of Chancery* were established which administered the principles of justice, equity and good conscience. Equity as administered by the early Courts of Chancery came in as a sort of relief to those suitors who could not get adequate relief or remedy under the Common Law from the common law judges.

In the early days the equity rules were not uniform as different Lord Chancellors who presided over these courts took a differing view as to the principles of equity and good conscience but these

rules were made more or less uniform by laying down a set of principles on which Equity Courts had to act during the term of office of Cardinal Wolsey as Lord Chancellor during the reign of Henry VIII.

The Chancery Court administering justice on the principles of Equity remained distinct and separate from the Court of King's Bench which administered justice according to the Common Law until the passing of the Judicature Acts of 1873 and 1875; after that these Courts were amalgamated and made into various divisions of one High Court of Justice.

3. Statute Law: Parliament came in later with statutes consolidating and codifying the law as laid down by the judges and incorporating suitable customs and usages thus creating what is known as the Statute Law. These statutes enacted by Parliament rank in *priority* to Common Law and Equity as Parliament is the supreme legislative body.

The Judicature Acts of 1873 and 1875: In order to avoid the hardship and inconvenience of having two separate and independent courts following two entirely different sets of principles, Parliament passed the Judicature Acts, establishing one Supreme Court of Judicature divided into the High Court and the Court of Appeal. For purely administrative purposes and for the sake of specialisation the work of the High Court was allocated to different departments known as the Chancery, the King's Bench, and the Probate, Admiralty and Divorce Divisions.

Establishment of High Courts in India: In India the Charter of the eighteenth century established Courts of Justice in Bombay, Madras and Calcutta, and introduced English Common and Statute Laws then in force in England. It was soon found undesirable as well as inconvenient to have to apply an entirely foreign system of law to a people in a different condition of society. The Courts at Calcutta, Madras and Bombay were empowered in 1781 and 1797, respectively, to apply Hindu and Mohammedan Laws. It was arranged, for example, that if a dispute arose between two or more Hindu litigants in the matter of contracts, the Hindu Law of Contracts was to be applied, whereas in the case of Mohammedans, the Mohammedan Law was to be enforced, if, on the other hand, one of the parties was a Hindu and the other a Mohammedan, the law applicable to the defendant had to be considered in deciding the suit. In 1862 High Courts were established for each of the Presidency towns of Calcutta, Madras and Bombay, which Courts continued

to apply the Hindu and Mohammedan Laws of Contracts until 1872 when the *Indian Contract Act* was passed.

Under the Constitution of India, Courts are now divided into three groups,

- (1) The Supreme Court, which is the highest Court in India today and under it,
- (2) The High Courts and
- (3) The Subordinate Courts.

4. The Law Merchant : The Law Merchant or *lex mercatoria* is a collection of legal principles which grew up in course of time with the progress of trade and commerce in England. Its basis was the customs and practices of merchants. At first it was dealt with separately in district courts but eventually it became part of the English Common Law. Besides the practice and usage of merchants as referred to above, a good deal had to be drawn from foreign treatises in the course of the natural growth of this branch of law. Thus it will be noticed that a portion of the law merchant of England was derived from foreign sources. Some was adopted from the Roman law and particularly the customs and practices concerning commerce were adopted from those prevailing in the leading cities of Southern Europe at different periods of history.

While dealing with the exact position, historical and legal, which the Law Merchant or *lex mercatoria* occupies in English jurisprudence, Chief Justice Cockburn in *Goodwin v. Roberts* (1875), L R. 10 Exch. 337, stated on page 346 to the effect that the Law Merchant was not a fixed and stereotyped branch of law, which was incapable of being expanded and enlarged so as to meet the wants and requirements in the varying circumstances of Commerce. His Lordship further added, "It is true that the Law Merchant is sometimes spoken of as a fixed body of law, forming part of the Common Law, and as it were coeval with it. But as a matter of legal history, this view is altogether incorrect. The Law Merchant as sometimes spoken of with reference to bills of exchange and other negotiable securities, though forming part of the general body of *lex mercatoria*, is of comparatively recent origin. It is neither more nor less than the usages of merchants and traders in the different departments of trade, ratified by the decisions of Courts of law, which, upon such usages being proved before them, have adopted them as settled law with a view to the interests of trade and the public convenience, the Court proceeding herein on the well-

known principles of law that, with reference to transactions in the different departments of trade. Courts of law, in giving effect to the contracts and dealings of the parties, will assume that the latter have dealt with one another on the footing of any custom or usage prevailing generally in the particular department. By this process, what before was usage only, unsanctioned by legal decision, has become engrafted upon, or incorporated into, the Common Law, and may be said to form part of it”.

At the earlier stage the English judges showed considerable disinclination towards the adaptation of foreign usages and customs but gradually as lawyers of newer schools succeeded them as judges a more developed outlook was taken. In the reign of Queen Anne, Chief Justice Lord Holt the first great judge of England began to recognize the customs and practices of European merchants on the Continent, though to a limited degree. He, for example, refused to admit or follow the custom of merchants as to the negotiability of promissory notes with the result that the great inconvenience suffered by merchants had to be removed through the passing of an Act of Parliament known as Statute 3 and 4 Anne, Ch. 9, whereby today the promissory notes are negotiable and can also be made payable to bearer. Prior to the passing of this Act a series of judgments were given by Lord Holt declaring them not negotiable. Later on between the years 1705 and 1793, *i.e.*, during the period of office of another great judge, *viz.* Lord Chief Justice Mansfield who came to be called the father of English Mercantile Law, the greatest possible progress was made in connection with the expansion of English Mercantile Law or the *lex mercatoria*. Lord Justice Mansfield had the advantage of being able to read and write foreign European languages and thus he was able to make a close study of the various books written by law writers of the continent of Europe at different centres and during different periods with the result that he was thus able to appropriate the customs and practices of English merchants which were largely influenced through the foreign centres, as trade and commerce in earlier days was mostly in the hands of continental merchants and England was gradually beginning to come in line with the development of its indigenous trade and commerce in the hands of indigenous businessmen. He thus largely expanded and enriched *lex mercatoria* in his own country in a series of most learned and well reasoned judgments which constitute, even to this day, the foundation on which the whole structure of the mercantile law of England has been built.

The *usage* as applicable to the Law Merchant may not necessarily be ancient, but provided it is general, a modern usage may be made part of this branch of law. It will thus be noticed that the Law Merchant is an evergrowing branch of law expanding and modifying itself—of course with certain limitations—with the changing circumstances of trade and commerce.

In *India*, the Law Merchant being mostly codified, the Courts have primarily to interpret the language of the codified Act, but as these codifications do not claim to embrace all the principles, in cases where some principles are not expressly dealt with in an Act, or where there is some doubt as to their interpretation, or in cases where certain branches of the Law Merchant are not codified at all, the Courts in India are generally guided by English authorities.

Mercantile Person: A mercantile person is a person who carries on commercial transactions and may be a single individual or a sole trader or a partnership or a company.

5. Roman Law: An important source of English law was the old Roman law and many a Latin maxim has found its way not only in English law but also in Indian Law.

SUMMARY

What is Law ?: 'Law' is used in many senses. In its widest sense it means any rule of conduct which follows a given pattern which is enforced through some sanction or fear of the consequences of disobedience.

In its narrowest sense 'Law' means civil law or the law of the country which is enforced in the law courts.

Classification of law: 1. Public Law 2. Private Law

(a) substantive law

(b) procedural law

Object of Law: The creation and protection of legal rights.

Knowledge of Law: As ignorance of law is no excuse every citizen is expected to know the law of his own country.

A knowledge of the principles of Mercantile law is essential for every businessman.

Mercantile Law is a branch of law concerned with business, trade and commerce.

Sources of Indian Mercantile Law: Indian Mercantile Law is mainly based on English Mercantile Law modified to suit Indian conditions. Therefore the sources of Indian Mercantile Law are:

1. The Common Law of England
2. The principles of justice, equity and good conscience.
3. Statute law or the law made by Parliament.
4. The Law Merchant or *Lex Mercatoria*.
5. Roman Law.
6. Case Law or previous judicial decisions.
7. Established Customs and Usage.

TYPICAL QUESTIONS

1. Explain the nature and growth of Mercantile Law and mention the various statutes that govern 'mercantile transactions'.
2. Trace the origin of Mercantile Law in England.
3. Discuss the sources of Indian Mercantile Law.
4. "Mercantile usage is the raw material, mercantile law is the manufactured article." Discuss stating the nature of the law Merchant and its importance in the development of Indian law.
5. "Equity follows the law." Comment.

Chapter 2

CONTRACTS

Law and Definitions

✓ “THE LAW of Contracts is intended to ensure that what a man has been led to expect shall come to pass; that what has been promised shall be performed.”

Anson on Contracts.

✓ Importance and Object of The Law of Contracts

The law of contracts is the most important and basic part of mercantile law. All of us enter into contracts in our day-to-day activities. For example, when we buy household goods, board a bus, order a meal at a restaurant, we create legal relations giving rise to rights and obligations.

The object of the law of contracts is to see that rights and obligations are honoured, that the expectations created by the promises of parties to an agreement are fulfilled and that legal remedies are available to an aggrieved party against the party failing to perform his part of the agreement.

As contracts are the basis of most business transactions, the law of contracts is of the greatest importance to all businessmen and others engaged in commercial activity. It helps them to plan ahead with the knowledge that what has been promised to them

will be performed or if it is not, the law will ensure them compensation for any loss that they may suffer.

Thus in the words of Sir Fredrick Pollock:

“The Law of Contracts may be described as the endeavour of public authority... .. to establish a positive sanction for the expectation of good faith which has grown up in the mutual dealings of men.”¹

Nature of Law of Contracts

The law of contracts is a part of the law of obligation under private law. It consists of a number of principles within the limits of which parties may enter into agreements voluntarily on their own terms and the courts will uphold such agreements.

English Law of Contracts

It should be noted that there is no English “Contract Act” and therefore the law of contracts in England is to be found in the Common Law as modified by various Acts dealing with special types of contracts, for example, the Bills of Exchange Act and the Sale of Goods Act, and in the decisions of judges.

Indian Law of Contracts

In India the law of contracts has been mostly codified and consists of the Indian Contract Act, 1872 which deals partly with the general principles of the law of contracts and partly with special types of contracts, and several other Acts passed from time to time dealing with special types of contracts not covered by the Indian Contract Act. For example, the Negotiable Instruments Act, the Indian Arbitration Act, etc.

Applicability of English law

Where the Indian law is silent or ambiguous it has been held that the English equity principles may be followed.² “The Court is governed by the provisions of the Contract Act and it is not entitled to go outside the four corners of the Act unless it is not clear”.³ Where the Indian law is not exhaustive the equity principles adopted by the courts of England may be followed.⁴

¹ Fredrick Pollock, *Law of Contracts*, p. 1

² *Moselle Soloman v. Martin & Co.* 92 Cal. 612; *Kanhaiyalal v. Dineshumchandra* (1959) M. P. 234

³ *S. P. Mukherji v. S. N. Chatterji* (1952) Cal. 93 (98)

⁴ *Chagla, J. in Gajanan Moreswar v. Moreswar Madan* (1942) I. L. R. Com. 670

The Indian Contract Act 1872 ✓

The Indian Contract Act of 1872 repealed the various statutes mentioned in the Schedule to that Act.

The Contract Act has been drastically modified, inasmuch as chapters dealing with Sale of Goods Law and Partnership law, viz., Chapters VII and XI have been superseded by the Indian Sale of Goods Act of 1930 and the Indian Partnership Act of 1932.

The first six chapters of the Indian Contract Act deal with the **general principles** of the law of contracts including the different stages of formation of a contract, its essential elements, performance, breach and its remedies. The other chapters deal with **special types of contracts** such as Indemnity and Guarantee, Bailment and Pledge and Agency.

The Act is not Exhaustive

The preamble to the Indian Contract Act shows that the Act is not an all-embracing Act but that it is intended only to **define and amend certain parts** of the law relating to contracts.⁵

The principles were introduced into the Act after careful deliberation and taking into consideration the special conditions applicable to India. The Act leaves all the usages and customs not inconsistent with the Act unaffected, and therefore, they will naturally be considered in deciding cases. In cases not provided for by the Contract Act or any other enactments the indigenous Law of Contracts can still be drawn upon by High Courts.

Definitions ✓

A contract is defined by Sir William Anson as "A legally binding agreement made between two or more persons by which rights are acquired by one or more to acts or forbearances on the part of the other or others".

Sir John Salmond calls a contract an agreement creating and defining obligations between parties.

Sir Fredrick Pollock defines a contract as "Every agreement and promise enforceable at law". It is this definition of Pollock which is the basis of the definition of the term "contract" in the Indian Contract Act which is as follows: "An agreement enforceable at law is a contract". Thus a contract involves two elements:

- (1) an agreement and
- (2) enforceability at law.

⁵ *Irrawaddy Flotilla Co. v. Bhagwandas* (1891) 18 Cal. 620, 18 I. A. 121.

An agreement is defined in section 2 (e) as, "every promise or every set of promises forming the consideration for each other". ✓

A promise is defined by section 2 (b) in the following words: "A proposal, when accepted, becomes a promise".

How an Agreement is Made ✓

An agreement may be made either by words, which may be written or spoken, or by conduct. It may even be made by a combination of both the above methods *i.e.* partly in words and partly by conduct. In the case of certain types of contract the statute applying to it may prescribe certain formalities such as an *ad valorem* stamp on a bill of exchange.

Obligation and Agreement ✓

The juristic concept of contract consists of two constituent elements viz., obligation and agreement. Obligation is defined as ~~the vinculum juris~~ or the bond of legal necessity which binds together two or more determinate individuals.

It follows from the definition that,

- (1) There must be at least two persons, one person under an obligation and the other person entitled to enforce the obligation. ✓
- (2) The obligation must be in respect of doing or abstaining from doing definite acts. Otherwise it may amount to slavery.
- (3) The obligation must relate to legal matters and not to social affairs, for example, when A accepts an invitation to dinner with B, there is no doubt an obligation or agreement to do or forbear from doing definite acts but this is only a social and not a legal obligation because there was no intention to create legal relations. Thus every agreement does not give rise to legal obligations nor is every legal obligation a contract.

Sources of Obligation ✓

As we have seen, all legal obligations do not arise from contracts. Enforceable obligations may arise from any of the following:

- (1) Contracts
- (2) Quasi-Contracts

(3) Torts

(4) Judgments of Courts

The law of contracts applies only to contractual obligations.

Agreements and Contracts

All contracts have their source in agreements but all agreements do not *ipso facto* become contracts. Sir John Salmond says: "The Law of Contracts is not the whole law of agreements nor is it the whole law of obligation; it is the law of those agreements which create obligations and of those obligations which have their source in agreements".

An agreement in general terms affecting obligations is of three types:

- (a) Agreements creating rights or obligations, e.g. contracts;
- (b) Agreements transferring rights or obligations e.g. conveyances, assignments, etc. and
- (c) Agreements destroying rights or obligations e.g. surrender, release, etc.

It should be noted that there are certain rights created by agreement which cannot properly be called contracts. For example, *A* and *B* may agree that *A* is to be the trustee. From this agreement there will arise a series of obligations to manage the property, to collect rents, to account for monies and so on, but all these are not contemplated or definitely agreed to or defined at the time of agreement. A breach of these obligations will be a breach of trust and not a breach of contract. Similarly a disregard of the obligations between husband and wife arising out of married status will not amount to a breach of contract. But will involve a different branch of law, the law of divorce.

SUMMARY

Importance of Law of Contracts: The law of contracts is the most important and basic part of mercantile law because contracts form the basis of business transactions.

Object of the Law of Contracts: The object of the law of contracts is to see that the expectations created by the promises of the parties to an agreement are fulfilled and that legal remedies are available to the aggrieved parties.

Nature of the Law of Contracts: Unlike other branches of law, the law of contracts does not state a number of rights and duties,

but lays down certain limiting principles within the framework of which the parties to an agreement may lay down their own terms and conditions. The parties thus make their own rules and regulations which will be upheld by the courts as long as they do not infringe any provision of law.

English Law of Contracts: There is no Contract Act in England. The law of contracts is therefore scattered among judicial decisions in common law and various Acts dealing with special types of contracts.

Indian Law of Contracts: The Indian Law of Contracts consists of:

- (1) The Indian Contract Act, 1872, and
- (2) Other Acts dealing with special types of contracts.

Applicability of English Law: There is no English Contract Act. Where Indian law is silent or ambiguous, the English principles of Equity may be followed in deciding Indian cases.

Indian Contract Act 1872: The first six chapters deal with the general principles including formation, performance, breach and remedies. The other chapters relate to special contracts namely indemnity, guarantee, bailment, pledge and agency.

Act not Exhaustive: It purports to define and amend certain parts of the law of contracts. The Act does not affect usages and customs which are not inconsistent with the Act.

Definition of Contract: An agreement enforceable by law is a contract [Sec. 2 (h)].

“Every agreement and promise enforceable at law is a contract”.
Pollock

“A contract is a legally binding agreement between two or more persons by which rights are acquired by one or more to acts or forbearances on the part of the other or others.”

Anson

Contract Agreement + Enforceability.

Sources of Obligation

1. Contracts
2. Quasi-Contract
3. Torts
4. Court Judgments

Prerequisites for a Valid Obligation:

- (1) At least two persons, one to carry out the obligation and the other to insist on it.

- (2) It must relate to a definite act or acts otherwise it may amount to slavery.
- (3) It must relate to legal matters and not merely social ones.

Agreements

- (1) There must be at least two persons.
- (2) The parties should have identity of mind (consensus *ad idem*)
- (3) There should be mutual communication between the parties, *i.e.* an offer and its acceptance.
- (4) There should be an intention to create legal relations.

Agreements and Contracts: Contracts have their source in agreements. But all agreements do not materialise into contracts—Some become sources of social ties—marital status—some are based on Trust, etc.

TYPICAL QUESTIONS

1. "The parties to a contract, in a sense, make the law of agreement for themselves" – Discuss.
2. What tests would you apply to ascertain whether an agreement is a contract?
3. What are the sources of obligation?
4. Define the following:—
 - (i) Obligation
 - (ii) Agreement
 - (iii) Contract
5. "The law of contracts is not the whole law of agreements nor is it the whole law of obligations, it is the law of those agreements which create obligations and of those obligations which have their source in agreements" – Discuss.
6. Define a Contract and distinguish it from an Agreement.
7. All contracts are agreements, but all agreements are not contracts—Discuss.

Chapter 3

CONTRACTS Essentials

Essentials of A Valid Agreement ✓

WE HAVE seen in the preceding chapter that “agreement” is a wider term than contract, that all contracts are agreements but all agreements are not contracts, and that only agreements which are enforceable at law are contracts. It is when an agreement is also contract that the parties to it have a legal remedy.

Section 10 of the Indian Contract Act states as follows:

“All agreements are contracts if they are made by free consent of parties competent to contract, for a lawful consideration and with a lawful object, and are not hereby expressly declared to be void”.

“Nothing herein contained shall affect any law in force in India and not hereby expressly repealed, by which any contract is required to be made in writing or in the presence of witnesses, or any law relating to the registration of documents.”

The following essentials are, therefore, necessary for a valid agreement:—

(1) offer and acceptance

- (2) intention to create legal relationship
- (3) free consent
- (4) legal capacity of parties
- (5) lawful consideration
- (6) lawful object
- (7) agreement not declared void or illegal
- (8) certainty
- (9) possibility of performance
- (10) necessary legal formalities.

We shall now deal briefly with each of the above essentials, and in detail in later chapters.

1. Offer and Acceptance

To find out whether parties to a contract have been of the same mind, Sir William Anson suggests the test of an offer and acceptance. The existence of a consensus *ad idem* which is a prime essential to the validity of a contract, can be inferred from the fact of an offer made by one party having been accepted by the other. The manifestation of mutual assent always invariably takes the form of an offer or proposal by one party accepted by the other. Thus a proposal when accepted becomes a promise or agreement. Offer and Acceptance are dealt with in detail in the next chapter.

2. Intention to Create Legal Relationship

The agreement should create a legal consequence. It is essential to a contract, using that word in its legal sense, that the parties to the agreement shall not only be *ad idem* as to the terms of their agreement but they shall have legal consequences and be legally enforceable.¹ There should be an intention to create a legal relationship, otherwise there cannot be a binding agreement between the parties.

ILLUSTRATIONS

In *Weeks v. Tybald*² the defendant in the course of casual conversation stated to the plaintiff that he would give £ 100 to any one marrying his daughter with his consent. The plaintiff having acted accordingly sued for the amount. The court observed, it was not reasonable that the defendant should be bound by such general words spoken to excite suitors and held that there was no legal offer as the statement was not capable of creating a legal relationship.

¹ *Rose Frank & Co. v. Crompton Bros.* (1925) A.C. 445.

² (1905) Noy 11.

In *Balfour v. Balfour*³ a husband agreed to pay £ 30 to his wife every month while he was abroad. On failure to pay, his wife sued him for recovery of the amount. The court held that she could not recover anything because it was a mere domestic agreement which did not intend to create any legal relations.

3. Free Consent

The consent of the agreeing parties must be genuine and given of their own free will. The consent must not be forced out of a party through coercion, or obtained through undue influence, deceit, etc. Free consent is dealt with in detail in a later chapter.

4. Legal Capacity of Parties

The parties to a contract should have the legal capacity to enter into a contract. Such persons should be of maturity of age, of sound mind, and should not be disqualified by any law to which they are subject from entering into a contract. Incapacity to contract may be due to minority, lunacy, idiocy, drunkenness or status. Capacity to contract is dealt with in detail in a separate chapter.

5. Lawful Consideration

Consideration is the most important element in a contract. It means something given or received. Unless each party to an agreement has given something and received something in return the agreement is not binding. "*Ex nudo pacto non oritur actio*". Out of a naked pact no cause of action arises. Consideration may be past, present or future. It must be real and lawful but need not be adequate. Consideration is dealt with in detail in a later chapter.

6. Lawful Object

The object of the agreement must be lawful. The object or consideration of an agreement is lawful unless,

- (1) it is forbidden by law, or
- (2) if permitted, it would defeat the provisions of any law or
- (3) is fraudulent or
- (4) involves or implies injury to the person or property of another or
- (5) the Court regards it as immoral or opposed to public policy. Unlawful agreements are dealt with in detail later in this chapter.

³ (1919) 2 K.B. 571.

7. Agreements not Declared Void or Illegal

An agreement which possesses all the ingredients of an offer and acceptance may materialise into a contract. A statute may, however, expressly declare certain contracts void, or illegal. In such cases the plaintiff is barred from coming to court for seeking relief.

8. Certainty of Meaning

An agreement should not contain vague or ambiguous terms. Due to vagueness or ambiguity, the meaning of the agreement may change.

“Agreements, the meaning of which is not certain or capable of being made certain are void” (S. 29).

ILLUSTRATIONS

- (a) *A* agrees to sell to *B* a “hundred tons of oil”. There is nothing whatever to show what kind of oil was intended and therefore the agreement is void for uncertainty. If, on the other hand, the special description of the oil is expressly stated, or where *B* dealt exclusively in, say, coconut oil, the agreement would not be uncertain and would therefore be good.
- (b) There is no uncertainty in an agreement to sell “all the grain in my granary at Ramnagar”. Also where *A* agrees to sell to *B* “one thousand maunds of rice at a price to be fixed by *C*” there is no uncertainty to make the agreement void as the price is capable of being made certain.
- (c) Where, however, *A* agrees to sell to *B* “my white horse for Rs 500 or Rs 1 000” the agreement is void as there is nothing to show which of the prices was to be given.

9. Possibility of Performance

The terms of the agreement should also be capable of performance physically and legally. An agreement to do an act impossible in itself cannot be enforced.

ILLUSTRATION

An agreement to make two parallel lines meet is an agreement to do something impossible and hence it cannot be enforced. impossibility is dealt with in detailed in a later chapter.

10. Legal Formalities

An agreement may be oral or in writing. If however, a particular type of agreement is required by law to be in writing witnessed, or registered etc., unless such legal formalities are carried out, the agreement cannot be enforced by law.

CLASSIFICATION OF CONTRACTS

Contracts may be classified according to:

- (i) Validity or enforceability, and
- (ii) Mode of Formation

1. Validity or Enforceability

Agreements which are valid or enforceable at law are, ~~as we have already learnt~~, contracts. These are agreements which satisfy all the requirements of law ~~which (we have just learnt under the heading, "Essentials of a Valid Contract")~~. Agreements which fall short of the legal requirements of a valid, enforceable contract, may be:

1. void
2. voidable
3. illegal, or
4. unenforceable

We shall now deal with each of these in detail.

1. **Void Agreement:** An agreement which is not enforceable by law by either of the parties is void [S. 2 (j)]. No legal rights or obligations can arise out of a void agreement.

It may be void *ab initio* i.e. from its very inception, as for example, an agreement without consideration, or subsequent events may render a valid agreement, void, as for example, the outbreak of war between the countries of the exporter and importer or the passing of an Act which renders such an agreement void.

It will be noticed that we have been referring to a void 'agreement' and not a void 'contract'. This is because to say that a contract is void is a contradiction in terms. Where there are no rights and duties there cannot be any contract.

The following agreements are void according to the provisions of various sections of the Indian Contract Act:

- (1) Agreements by persons who have no legal capacity to be bound by a contract (S. 11)
- (2) Agreements entered into through a mutual mistake of fact between the parties (S. 20)
- (3) Agreements, the object or consideration of which is unlawful (S. 23)
- (4) Agreements, part of the consideration or object of which is unlawful (S. 24)

- (5) Agreements made without consideration (S. 25)
- (6) Agreements, in restraint of marriage of any person other than a minor (S. 26)
- (7) Agreements in restraint of trade, with certain exceptions (S. 27)
- (8) Agreements in restraint of legal proceedings, except contracts to refer to arbitration (S. 28)
- (9) Uncertain agreements (S. 29)
- (10) Wagering agreements (S. 30)
- (11) Impossible agreements (S. 56)

These are explained in detail in the later chapters of this Part.

2. Voidable Contract: An agreement which is enforceable by law at the option of one or more of the parties but not at the option of the other or others is a voidable contract. [S. 2 (i)] Notice that the word used here is "contract" and not just "agreement". This is because the rights and duties are created and the contract is valid until the option to avoid it is exercised by the person whose consent to the agreement was not free. Notice that the option to avoid or to be bound by the contract can be exercised only by the party whose consent was not free but was obtained by coercion, undue influence, fraud or misrepresentation. The other party who induced the consent cannot take advantage of his own fraud, etc. because of the maxim, "He who comes into Equity must come with clean hands".

Thus a voidable contract is valid and enforceable until it is repudiated by the party entitled to avoid it.

The following agreements are voidable under the Indian Contract Act because the consent is not free or genuine. These are agreements brought about by:

1. Coercion (S. 15)
2. Undue influence (S. 16)
3. Misrepresentation (S. 18)
4. Fraud (S. 17).

We shall deal with each of these in detail later.

The distinction between a void agreement and a voidable contract, we have seen, is that a void agreement cannot be enforced by either party whereas a voidable contract may be avoided or enforced by one of the parties *i.e.* by the party whose consent was not free. The distinction is important because in the case of a void agreement

third parties cannot acquire any right from a person claiming title under such agreement while in the case of a voidable agreement third parties can acquire a valid title from a person claiming title under such an agreement, provided the said title has been acquired by them before the agreement is set aside by the person entitled to do so.

ILLUSTRATION

A sells certain goods to *B*. At the time the contract is made the goods are already destroyed by fire but this fact is not known to either *A* or *B*. Meanwhile *B* sells the subject-matter of the contract to *C*. When the contract is discovered to be void *ab initio* i.e. from the beginning neither *B* nor *C* can claim anything from *A*. However, if *A* had been induced by *B*'s fraud to sell certain goods to *B*, on discovering the fraud *A* is entitled to set aside the contract which is voidable at his option. If, before he avoids the contract, the goods are sold by *B* to *C*, a third party, *C* acquires a right in the goods because until the contract is avoided it is perfectly valid.

3. Illegal Agreement: All void agreements are not necessarily illegal though all illegal agreements are void, and it is often difficult to tell whether an agreement is merely void or also illegal. Every disregard or disobedience of the law does not amount to illegality. An illegal act is tortuous or criminal.

ILLUSTRATION

An agreement where the consideration or object is to commit a tort or a crime, or to defraud the public revenue or to interfere with the course of justice would be considered illegal.

Effect of Illegality

Where the parties are not in *pari delicto*, the party who is innocent is entitled to recover the goods delivered or the money paid.

The parties are considered not to be in *pari delicto* where the party who is given money, property or goods,

- (1) was made to do so under fraud, oppression or duress of the other party, or
- (2) was an entirely ignorant man whose ignorance was taken advantage of by a clever person, or
- (3) where a statute has been passed prohibiting a contract with a view to protect any person or class of persons or for protecting one set of persons from another owing to the peculiar situation and condition of one class being liable to be oppres-

sed or imposed upon by the other and under such a contract the person who is protected by the statute has parted with his money or property.

The money or property has also to be returned in case no part of the illegal purpose has been carried out and the party repudiates the contract. This cannot be done, however, in case any part of the illegal purpose has been carried out.

Difference Between Void and Illegal ✓

There is a difference in the legal effect of an agreement which is illegal and one which is merely void. While both void and illegal agreements have no legal effect between immediate parties to such agreement, a merely void agreement does not affect collateral agreements whereas an illegal agreement taints all collateral agreements and no action can be taken for recovering any money paid or property transferred under an illegal agreement or for breach of such agreement. Thus the difference lies in the effect upon collateral *i.e.* subsidiary transactions.

ILLUSTRATION

Money lent or advanced for carrying out a contract which is merely void may be recovered but not when a contract is illegal because of the maxim "*Illegality vitiates all collateral transactions*". Similarly, if *A* agrees with *B* to commit a robbery and divide the proceeds and if *X* lends *A* a certain sum of money to buy tools with which to commit the robbery, the original contract between *X* and *A* is also tainted with the illegality and hence *X* cannot recover the amount lent by him to *A*. This is based on the principle, *ex turpi causa non oritur actio*, meaning, out of turpitude no cause of action arises. In fact the court goes out of its way to assist the defendant by compelling him not to entangle himself in such an illegal alliance on the principle *in pari delicto potior est conditio defendantis*, meaning, the position of the defendant is better in cases of equal guilt.

Thus agreements which are against the statute can be based on the general legal maxim *ex dolo malo non oritur actio*, meaning, no court will lend its aid to a man who finds his cause of action upon an immoral or an illegal act.

4. **Unenforceable Agreement:** An unenforceable agreement is one which may be valid in the sense that rights are created and obligations imposed which the law recognises but which is not enforceable by action in Court because of the absence of some particular evidence which the law requires.

In India an otherwise valid contract may be unenforceable because either the document which evidences it *e.g.* a promissory

note, cannot be produced in evidence or a document which requires to be stamped is either not stamped or understamped. In such a case, if the stamp is required merely for revenue purposes, as in the case of a receipt, the requisite stamp may be affixed on payment of a penalty and the document tendered in evidence so that the contract becomes enforceable. If, however, the technical defect cannot be cured the contract remains unenforceable *e.g.* in the case of an unstamped bill of exchange or promissory note.

Under the **English Statute of Frauds**, certain contracts were required to be evidenced by some memorandum or note in writing signed by the party to be charged, otherwise no action could be brought. Formerly there were five such contracts but now since the passing of the Law Reform (Enforcement of Contracts) Act, 1954 there are only two. They are: (1) any special promise to answer for the debt, default or miscarriage of another, *i. e.* a contract of guarantee, and (2) any contracts for the sale or disposition of land or any interest in land. The original provision in the Statute of Frauds relating to land was repealed and re-enacted by the Law of Property Act, 1952, Section 40.

II. Mode of Formation

Another method of classification of contract is into:

1. Express
2. Tacit or Inferred
3. Implied or Quasi Contracts

1. **Express Contract:** When the offer or acceptance is made in words either spoken or written, the promise is said to be express. When both the offer and acceptance are in words the whole contract is said to be express.

2. **Tacit or Inferred Contract:** When no words are used but the behaviour and attitude of the parties to the agreement and their conduct during the course of the agreement leads to an inference that they intended to enter into a binding agreement we can call the transaction a tacit or inferred contract.

ILLUSTRATION

If *A* goes to a bookstall, picks up a book, pays the price printed on it, and hands over the book to the salesman who wraps it up and hands it back the paying of the price by *A* is the offer and the giving away of the book by the bookstall attendant is the acceptance. In this case both offer and acceptance can be inferred by the conduct of the parties.

3. **Implied or Quasi Contracts:** When there has been no agreement between the parties, *i.e.* no offer or acceptance, there can be no contract. However, in certain circumstances, on the principles of Equity that “no person shall be permitted to enrich himself at the expense of another” the law recognises certain rights and obligations. As such obligations do not arise out of a contract they cannot be termed contractual obligations but as they resemble those under a contract the term “*quasi-contract*” is used.

Sections 68 to 72 deal with quasi-contracts or certain relations resembling those created by contract. They are:

- (1) Claim for necessities supplied to person incapable of contracting or on his account. (S. 68)
- (2) Reimbursement of person paying money due by another in payment of which he is interested. (S. 69)
- (3) Obligation of person enjoying non-gratuitous act. (S. 70)
- (4) Responsibility of finder of goods. (S. 71)
- (5) Liability of person to whom money is paid, or thing delivered, by mistake or under coercion. (S. 72)

We shall now deal with each of these in some detail.

(1) *Claim for necessities supplied to a person incapable of contracting, or on his account* (S. 68): When goods which are considered necessities suited to his condition in life are supplied to a person incapable of being bound by a contract such as a minor or a lunatic or to such person's dependents, the supplier is entitled to be reimbursed from the **property** of such incapable person. Unlike in the case of a contract there is **no personal liability**.

ILLUSTRATION

A supplies the wife and children of *B*, a lunatic, with necessities suited to their condition in life. *A* is entitled to be reimbursed from *B*'s property.

(2) *Reimbursement of a person paying money due by another in payment of which he is interested* (S. 68): This only applies to **payments** which are made for the **protection** of the interest of the **person making such payment** and not to payments made out of any other motive.

ILLUSTRATION

B holds land in Bengal, on a lease granted by *A*, the zamindar. The revenue payable by *A* to the Government being in arrears, his land is advertised for sale by the Government. Under the revenue law, the consequence of such sale will be the annulment of *B*'s lease. *B*, to prevent the sale and the consequent annulment,

of his own lease, pays to the Government the sum due from *A*. *A* is bound to make good to *B* the amount so paid.

The essential elements for such a quasi-contract are:

- (a) The payment must be made for the protection of the interest of the payer.
- (b) The person bound by law to pay should be another and not the person who makes the payment.
- (c) The payment should have been made on behalf of the person who was bound by law to pay.

(3) *Payment or restoration by a person enjoying the benefit of a non-gratuitous act (S. 70):*

ILLUSTRATION

- (a) *A*, a tradesman, leaves goods at *B*'s house by mistake. *B* treats the goods as his own. He is bound to pay *A* for them.
- (b) *A* saves *B*'s property from fire. *A* is not entitled to compensation from *B* if the circumstances show that he intended to act gratuitously.

(4) *Responsibility of finder of goods (S. 71):* A person who finds goods belonging to another and takes them into his custody, is subject to the same responsibility as a bailee. The responsibility of a bailee is to take as much care of the goods bailed to him as would be expected of a man of ordinary prudence in similar circumstances (S. 111). Thus a finder of goods is liable for negligence. He is also under a duty to try to find the true owner.

In *English Law*, the law implies the contract from the circumstances. The most common forms of such contracts implied by law are (1) for an action upon an account stated, or (2) for money paid by one person to the use of another, or (3) for money due upon a judgment in a foreign court or for money received by one person for the use of another person. The case of **an action upon an account stated** arises where the party who cares the money admits in some form or other that the said sum is due. The usual form in which an account is stated is by passing an I.O.U. Of course in the case of such account stated action, the defendant is quite at liberty to prove that there was some mistake in his admission or that the debt was void for want of consideration or that the same was illegal. The **action for money for the use of another** may arise where *X* requests *Y* to pay a certain debt owed by *X* on *X*'s behalf which is done by *Y*. On such payment by *Y* of the said debt there is an implication in law of a promise by *X* to repay his money to *Y*, irrespective of the fact that there was no express promise by *X*

to refund the money. The case of an action for money had and received for the use of another may arise where *X* has paid money to *Y* either under a mistake of fact or on a consideration which has failed entirely or under duress or extortion or fraud. The mistake of course must be of fact and not of law and the extortion or compulsion must be illegal and not one under legitimate process of law. The failure of consideration has also to be complete and not partial.

(5) *Liability of a person to whom money is paid, or thing delivered by mistake or coercion (S. 72).*

ILLUSTRATION

(a) *A* and *B* jointly owe Rs 100 to *C*. *A* alone pays the amount to *C*, and *B*, not knowing this fact, pays Rs 100 over again to *C*. *C* is bound to repay the amount to *B*.

(b) A railway company refuses to deliver up certain goods to the consignee except upon payment of an illegal charge for carriage. The consignee pays the sum charged in order to obtain the goods. He is entitled to recover so much of the charge as was illegally excessive.

(c) *A* paid sales tax levied on his forward transactions in bullion. Afterwards the tax was declared *ultra vires*. It was held that *A* was entitled to recover the amount paid and that section 72 was wide enough to include a mistake of law.⁴

(d) *A* made an excess payment under the mistaken belief that it was the controlled price. Held that such excess could be recovered.⁵

(e) An insurance company through oversight paid the amount on a policy which had lapsed due to failure to pay premiums. Held that the insurance company could recover the amount paid.⁶

(f) An insurance company, in the mistaken belief that the goods insured had been destroyed when they had actually been sold, paid the amount on the policy. Held that the company was entitled to recover the money.⁷

English Law—Mode of Formation

The English law has divided contracts into three main classes as to the form in which they are to be entered into, *viz.*

- (1) Contracts of Record,
- (2) Simple contracts, and
- (3) Speciality contracts.

(1) **Contracts of Record** are obligations which arise through entries in parchment rolls or records of a court of law. The most familiar type of this contract is a judgment of a court of record. This judgment depends as far as its binding force is concerned on

⁴ *Sales Tax Officer, Benaras v. Saraf*, (1959) S.C.J. 53

⁵ *Lakshmanprasad v. Kamalbai*, 1960 Mad. 335

⁶ *Kelly v. Solar* (1841) 9 M. & W. 54

⁷ *Norwich v. Price*, (1934) A.C. 455.

the authority of the judge as distinguished from agreement between the parties. Frequently recognizances are also given by parties to judges and courts as representing the Crown. These recognizances promise to do some particular act or to submit to a fine or penalty such as an undertaking in a criminal charge to come for judgment if called upon or to pay a specific sum. These are also contracts of record. The record conclusively proves itself and admits of no dispute.

(2) **Simple contracts** may be either oral, or in writing. They must be supported by consideration.

(3) **Speciality contracts** in England are contracts which are required to be either written or printed, sealed and delivered, and if executed after January 1, 1926, signed by the promisor if the promisor is an individual. They are known as "deeds" and do not require to be supported by valuable consideration. An instrument written, sealed and signed but delivered subject to a condition is called an "escrow". **Simple Contracts which must be in Writing in English Law:** We have learned that certain contracts must be under seal in *English law*, e.g., those made without consideration, or by corporations. These are speciality contracts. Other contracts are known as simple contracts. At *Common Law*, simple contracts may be in writing or by word of mouth, but by several statutes particular kinds of contracts are unenforceable unless they are actually expressed in writing while certain others must be proved by written evidence of their terms.

The following are some of the chief kinds of simple contracts which must actually be in writing:—

- (1) Contracts of Marine Insurance.
- (2) Negotiable Instruments—e.g., bills of exchange, promissory notes, cheques, etc.
- (3) Bills of Lading,
- (4) Money-lending contracts whereby the borrower undertakes to repay money borrowed from a money-lender or to pay interest on such loan.
- (5) Special contracts by which railway and canal companies are exempted from liability for loss of or injury to goods received for carriage.

Indenture and Deed Poll: We have seen what a contract by deed happens to be in *English Law*. It may, however, be added that the term **deed** is applied also to an instrument by which property is

conveyed by one person to another. The most common form of such deeds is to be found in connection with leases of houses and lands or premises for business purposes. These deeds contain what are called covenants which are promises by one party of the deed to the other. In the same manner there is a mortgage deed between the mortgagor of property and the mortgagee. There may be a deed promising to pay the money for which no consideration has been given and in the case of such deeds where covenants are by one side only the party who makes these promises is the only party who signs, seals and delivers the instrument. In the case of deeds such as mortgage deeds or leases both the parties give promises to each other and thus all parties granting such covenants must sign, seal and deliver.

Formerly the words indenture and deed poll had a peculiar significance. An indenture was made where there were more than one party. Here a number of copies had to be prepared to be kept by each of the parties to such a deed and in further preparation of the same, these deeds were cut or indented on the margin to correspond with each other and thus they came to be called indentures. Nowadays although this practice of indenting has disappeared, such deeds are still known as indentures. Where, however, there was only one party making the covenants, naturally only one deed was prepared and thus there was no necessity of indenting it. Such a deed was called a deed poll.

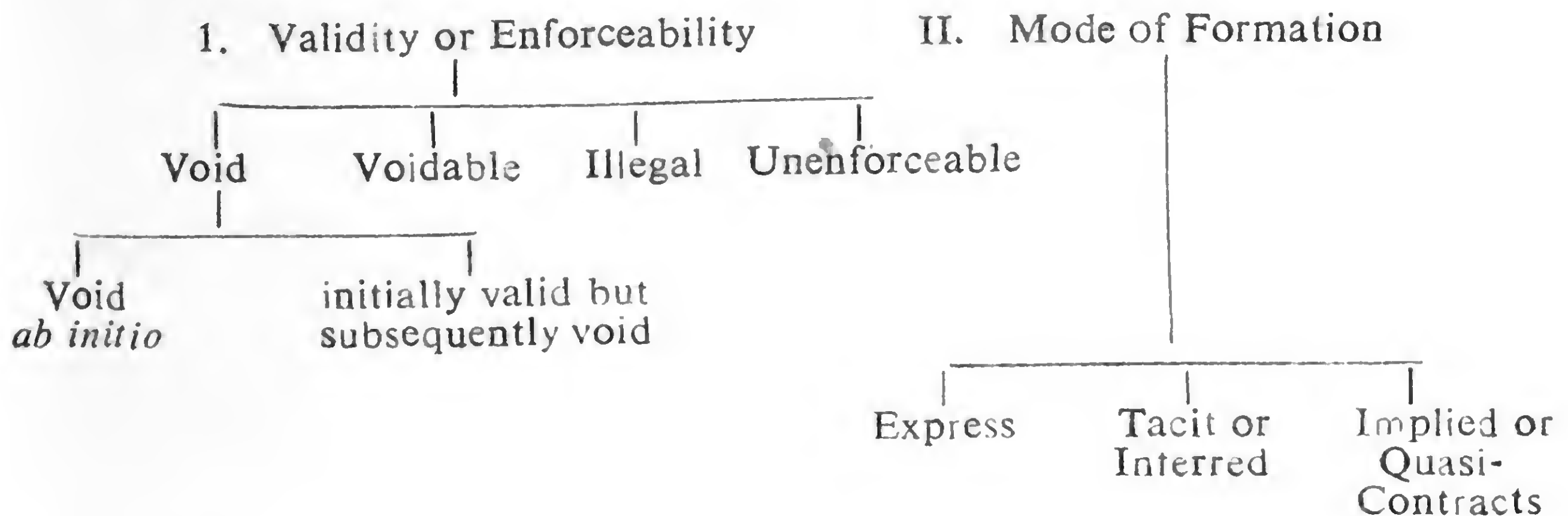
SUMMARY

Essentials of a Contract

1. There must be an agreement. This involves two parties—one making the offer and the other accepting it.
2. The parties must intend to create a legal relationship.
3. The consent given or obtained must be genuine and free.
4. The parties should have capacity to enter into contracts.
5. The agreement must be supported by lawful consideration.
6. The object of the agreement must be lawful.
7. The agreement should not be declared illegal or void.
8. The terms of the agreement must be certain and not ambiguous or capable of being made certain.
9. The agreement must not be impossible of performance.
10. The necessary formalities must be observed.

Classification of Contracts: Contracts may be classified according to

- I. Validity or Enforceability and
- II. Mode of Formation.



1. Void Agreement

An agreement not enforceable by law by both parties is said to be void. It is a nullity as it does not give rise to any rights and obligations. An agreement may be void *ab initio* or a valid agreement may subsequently become void.

2. Voidable Contract

An agreement which is enforceable by law at the option of one or more of the parties thereto but not at the option of the other or others is a voidable contract. Contracts made without free consent are voidable.

3. Illegal Agreement

Illegal agreements are those which are made in violation of a statute or the provisions of the general law. All illegal agreements are also void but all void agreements are not illegal.

Difference between Void and Illegal Agreements

The difference between an illegal agreement and a void agreement is that,

- (1) Collateral transactions become void in the case of an illegal agreement but not in the case of a merely void agreement and
- (2) No action can be had for recovery of payment made or property transferred in the case of an illegal agreement but such payment of property may be recovered by action in court in the case of a merely void agreement.

4. Unenforceable Contracts

An agreement may satisfy all the essentials of a valid agreement but may not be enforceable in Court because some essential evidence is missing. For example, a document which requires to be stamped is not stamped or is understamped.

Distinction between void and voidable

1. As a void agreement is a nullity third parties cannot acquire any rights under it.

As a voidable contract is valid until it is repudiated, innocent third parties may acquire rights under it before it is sought to be repudiated.

2. In a void agreement there are no rights or obligations, therefore neither party can enforce it.

In a voidable agreement rights and obligations exist but one of the parties has the option to nullify them.

Mode of Formation

1. **Express**—When the agreement is formed by words spoken or written.
2. **Tacit or Inferred**—When no words are used but the agreement is inferred from circumstances or the conduct of the parties.
3. **Implied or Quasi-Contracts**—When there is no contract in fact but it is implied in law in certain cases where a person cannot be permitted to enrich himself at the expense of another.

Quasi Contracts

Quasi-contracts are not agreements but in certain circumstances the law imposes an obligation similar to that arising under a contract. The following are quasi-contracts:

- (1) Claim for necessities supplied to person incapable of contracting or on his account (S. 68)
- (2) Reimbursement of a person paying money due by another in payment of which he is interested (S. 69)
- (3) Obligation of person enjoying non-gratuitous act (S. 70)
- (4) Responsibility of finder of goods (S. 71)
- (5) Liability of person to whom money is paid, or thing delivered, by mistake or under coercion (S. 72)

TYPICAL QUESTIONS

1. Who can enter into contracts? State the essentials of a valid contract in brief.
2. "An agreement enforceable by law is a contract".
Discuss the definition, bringing out the essentials of a valid contract.
3. Write short notes on the following:
 - (a) Voidable and Unenforceable contracts
 - (b) Implied or Quasi Contracts
 - (c) Void and voidable contracts
4. Define a contract. What is the difference between void and voidable contract? Explain with an example for each type of contract.
5. Explain transactions which are in the nature of contracts.
6. (a) What are Void Agreements?
(b) *A*, by misrepresentation, leads *B* erroneously to believe that 500 maunds of indigo are made annually at *A*'s factory. *B* examines the accounts of the factory which show that only 400 maunds were being made. Thereafter, he buys the factory. Is the contract voidable on account of *A*'s misrepresentation?
7. Define Quasi Contracts and discuss the rights of parties to them.
8. What are the main requisities of a valid agreement?
9. "The law of contracts is intended to ensure that what a man has been led to expect shall come to pass, that what has been promised to him shall be performed." Discuss in the light of this statement the essentials of a valid contract.

Chapter 4

CONTRACTS

Offer and Acceptances

Definition of Agreement

THE INDIAN Contract Act *defines an agreement* as: "Every promise and every set of promises forming the consideration for each other" [2 (e)].

It may also be defined as an offer and an acceptance by which two or more persons agree to do, or to abstain from doing, a particular act, *i.e.*, when a proposal is accepted, the proposal turns into a promise and an agreement is formed.

The person who makes the proposal is the promisor and the person who accepts it is the promisee.

ILLUSTRATION

When there are a set of promises forming the consideration for each other, the promises are reciprocal as each party is the promisor as to the liability he undertakes and the promisee of the benefit he receives; *e.g.*, *A* says to *B*, "Will you buy my watch for Rs 300?" and *B* replies "Yes": there is then an agreement, *A* being the promisor and *B* the promisee as regards *A*'s proposal to sell while *B* is the promisor and *A* the promisee in respect of *B*'s promise to buy.

Lighted Match Analogy

In a very apt analogy Sir William Anson explains the relationship between offer and acceptance. He compares the offer

to a train of gunpowder and acceptance to a lighted match. As soon as a lighted match is thrown on a train of gunpowder, there is an instantaneous explosion. The gunpowder by itself is inert or inactive, but it is the lighted match which causes the fusion resulting in a chemical reaction. So also, an offer by itself does not create any legal relationship between the offeror and the offeree. The offer by itself is inert, but as soon as the offer is accepted by the offeree, a legal relationship is established between the parties and the offer is converted into a promise which imposes an obligation on the offeror. The gunpowder might have lain damp or the train might have been removed, in which case the lighted match will not produce the desired effect, namely, an explosion. Similarly the offer might be revoked before it is legally accepted so that no legally binding contract can be made.

Definition of Proposal

The definition of an offer or proposal given in the Indian Contract Act is "when one person signifies to another his willingness to do or to abstain from doing anything with a view to obtaining the assent of that other to such act or abstinence he is said to make a proposal" [S. 2 (a)].

An offer is therefore a communication made with the object of obtaining the consent of the person to whom the communication is made.

Express and Implied Offer

An offer or its acceptance or both may be made either by words (written or oral) or by conduct. However, in order to make a contract of this class, both the parties must be '*ad idem*' i.e. in absolute agreement as to what they are doing and if that is so and such an agreement is supported by consideration, there is a binding contract between them.

When the intention is expressed in words, the offer or acceptance, as the case may be, is said to be express but when the intention is to be inferred from conduct or surrounding circumstances it is said to be implied.

ILLUSTRATION

A offers to buy B's motor-car for Rs 5,000. B can accept this offer by sending the car itself. Here B's acceptance is implied from his conduct. By running buses over certain routes the transport company impliedly offers to carry passengers from one place to another at a fixed rate and there is an implied acceptance of the offer

when an intending passenger boards the bus. In such circumstances both the offer and its acceptance may be implied from conduct and no words need be used.

General and Specific Offer

An offer may be made

- (1) to a particular person, or
- (2) to a group or class of persons or
- (3) to the general public.

An offer is said to be **specific** when it is addressed to a particular person or to a specified group or class of persons.

ILLUSTRATION

- (a) A makes an offer to B, this is a specific offer made to a particular person, B.
- (b) A makes an offer to "any student of the Bombay University". This is a specific offer to a specified group or class of persons.

When an offer is addressed to an unascertained body of persons even though it may be accepted by an ascertained individual, it is known as a **general offer**.

ILLUSTRATION

When a person advertises a reward to any person who finds his lost dog, the offer is not made to any particular individual though it is capable of being accepted by the particular individual who finds the dog and claims the reward.

Sir John Salmond calls a specific offer an offer to an individual and a general offer an offer at large.

ILLUSTRATION

The leading case on general offers is *Carlill v. Carbolic Smoke Ball Co.*¹ In that case it was held that the proposal need not be made to any particular person but may be made to the general public, but if it is accepted by any particular person it would constitute an agreement, provided of course all conditions precedent to such acceptance are fulfilled. Here the defendants who prepared a medicinal preparation called, "Carbolic Smoke Ball" advertised it offering to give £ 100 reward to any person who should contract influenza, cold etc., after having used the preparation three times daily for two weeks. The advertisement also stated that £ 100 was deposited with a particular bank, "showing our sincerity in the matter". The plaintiff, Mrs. Carlill bought this medicine on the faith of these advertisements and used it in the manner and for the period specified, but nevertheless contracted influenza. It was argued on behalf of the company that a notification of the acceptance should have been communicated to the company and that the alleged offer was an advertisement or 'puff' which no reasonable person could consider seriously.

¹ (1893) 1QB 256

It was held that this was one of the class of cases where, as in the case of a reward offered for information or for the recovery of lost property, no acceptance of the offer except the performance of the condition was necessary. Thus all the elements which are necessary to form a binding contract enforceable in law were there and that the plaintiff was entitled to £100 as stated in the advertisement. The above case is important as it lays down and illustrates the following principles:

1. An offer may be made to the general public in which case it can be accepted by any particular individual.
2. An offer which is made to the general public is not a mere "offer to treat" or an offer to negotiate but an offer itself which may develop into a binding agreement if it is accepted by any person who performs its conditions.
3. An advertisement need not always be a mere invitation to offer but may in certain circumstances amount to an offer.
4. The acceptance of a proposal should generally be communicated, but since this provision is for the benefit of the offeror, the offeror may dispense with such notification.
5. The mere extravagance of an offer or the mere probability that the promisor may be subject to several actions is no ground for exonerating a party from a contract which is otherwise valid.

The same rule would apply to an advertisement offering a specific reward for a lost dog to the finder.

Essentials of a Valid Offer

- (1) An offer must be made with a view to obtain an acceptance. (S. 26)
- (2) An offer must be made with the intention of creating legal relations, otherwise it is no offer in the eye of the law. For example, a mere social invitation does not give rise to any legal relationship.²
- (3) The terms of the offer must be certain or capable of being made certain. They must not be vague or ambiguous.

If A offers to sell "my house" to B and if A owns more than one house the terms of the offer are uncertain and therefore it is not a valid offer. In one case³ where the offer was to take a lease of a house for three years at £85 per annum, if the house was "put into thorough repair, and the drawing rooms handsomely decorated according to the present style", it was held that the agreement was void on the ground that the clause in question had imported uncertainty into what might otherwise have amounted to a contract. In *Montreal Gas Co. v. Vasey*⁴

² *Balfour v. Balfour* (1919) 2 K. B. 571

³ *In Taylor v. Portington*, (1855) E. R. 128

⁴ (1900) AC 595

the plaintiff relied on a clause that if the company were satisfied with him as a customer, the company would favourably consider an application for renewal of the contract, but the court held that there was nothing in these words to create a legal obligation. In *British Monophone Ltd., v. King & Record Manufacturing Co.*⁵ it was held that an agreement to renew a contract "on terms to be hereafter agreed" would not result in a contract.

(4) An offer must be distinguished from (a) A mere declaration of intention and (b) A mere invitation for offers.

(a) **A Mere Declaration or Statement of Intention:** If the statement is a mere declaration of intention naturally it has not been intended that it should be accepted and thus its purported acceptance cannot constitute an agreement.

ILLUSTRATIONS

(a) *Auction Cases:* An auction sale of certain articles was advertised. The plaintiff travelled a distance to attend the sale in order to bid for the articles but on his arrival he found that the sale was cancelled. He sued the auctioneer for breach of contract on the ground that the advertisement was an offer made to the public which he had accepted by travelling to the place. The Court held that the advertisement was merely a declaration of intention and that there could not be an acceptance.⁶

(b) In casual conversation a father stated that he would give £100 to any one who married his daughter with his consent. The plaintiff married the daughter with the father's consent. In a suit to claim the £100 it was held that such "general words spoken to excite suitors" was a mere statement of intention and therefore not binding.⁷

(c) *Railway Time-Table:* The question may arise whether statements in a railway time-table amount to offers, and whether the conduct of an intending passenger in applying for a ticket on tendering the proper fare, amounts to an acceptance so as to entitle him to sustain a claim for damages in case of refusal by the Railway Administration to issue a ticket. It is the tendering of the fare by the passenger which is the offer and the issuing of the ticket by the Railway, which is the acceptance. It has been held that announcements of an auction or of the running of a train at a stated hour will be actionable only in Tort provided the statements amount to fraud or deceit.⁸

Thus whether a particular statement is an actual offer or only a mere declaration of intention is a question of fact which the Court alone can decide looking to the circumstances of the case.

(b) **An Invitation to Make an Offer:** An invitation to make an offer or "an offer to treat" must be distinguished from an actual offer. This distinction again depends upon the intention of the

⁵ (1935) 152 L.T. 589

⁶ *Harris v. Nickerson*, L.R. 8 Q.B. 286

⁷ *Weeks v. Tybald*, Noy 11

⁸ *McMonus v. Fortescue* (1907) 2 K.B. 1

parties, which in doubtful cases can only be determined after considering the nature of the transaction and the circumstances of the case.

ILLUSTRATIONS

(i) *Invitation for Tenders*: When tenders are invited for the supply of certain goods unless accompanied by words indicating that the goods would be sold to the highest bidder there is no offer from the party who invites the tenders but every tender is an offer and it is for the party inviting tenders to decide which offer if at all to accept.⁹

(ii) *Price List, Catalogue, Goods Displayed in Shop Window*: On the same principle it has been held that a price list or catalogue, or goods displayed in a shop window with price tags on them, are not offers for sale by the shopkeeper but are only an indication of the shopkeeper's intention to consider offers from members of the public. Thus they are so many invitations to the public to offer which may or may not be accepted. In one case certain articles were displayed in a self-service shop on shelves with price tags on each article. A customer picked up some of these articles and went to the cashier who totalled the prices and accepted the amount. It was held that when the customer picked up the articles from the shelves it constituted an implied offer to buy articles and not an acceptance of the shopkeeper's offer of sale.¹⁰

(iii) *Request for Quotations*: Similarly, a request to send the lowest quotation does not constitute an offer. In *Harvey v. Facey*¹¹, there were three telegrams as follows:

1. Harvey to Facey: "Will you sell Bumper Hall Pen? Telegraph lowest price, answer paid".
2. Facey to Harvey: "Lowest price for Bumper Hall Pen £900".
3. Harvey to Facey: "We agree to buy Bumper Hall Pen for £900 asked by you".

There was no reply to the third telegram. When Harvey sued Facey it was held that there was no contract. There had been no offer until the third telegram but as there was no reply, the offer could not be said to be accepted and therefore there could be no contract.

(5) Offer Must be Communicated: Every offer must be communicated, otherwise it may be very difficult to know whether the parties are of the same mind. This is true of specific as well as general offers. The communication of an offer is complete when it comes to the knowledge of the person to whom it is made (S. 4).

ILLUSTRATION

In *Lalman Shukla v. Gouri Dutt*¹² the defendant sent the plaintiff, who was in his service, in search of his missing nephew. Subsequently, the defendant anno-

⁹ *Spencer v. Harding*, L.R. 5 C.P. 561

¹⁰ *Pharmaceutical Society of G.B. v. Boots Cash Chemists* (1952) 2 All. E.R. 456

¹¹ (1893) A.C. 552

¹² (1913) 11 A.L.J. 489

united a reward for information relating to the boy, but before the plaintiff knew of the announcement, he had found the boy. In a suit to recover the promised reward, the court observed that there can be no acceptance unless there is a knowledge of the offer, but preferred to rest its decision on the ground that it was the plaintiff's duty as the servant of the defendant to search for the boy.

Communication and Acceptance of Special Conditions

The general rule of law is that where an offer contains on the face of it the terms of a complete contract, the acceptor will not be bound by any other terms intended by the offeror to be included in it.

Cases frequently arise where, in cases of contract, special conditions are printed at the back of the document, which conditions one party attempts to make binding on the other, *e.g.*, a ticket or a pass having a number of conditions on the back of it. How far these conditions are binding will depend on whether or not the person taking such a ticket had notice of the conditions or could have had notice by exercising ordinary intelligence. This rule would apply to a consignment note or a cloak room receipt on the back of which conditions are printed. However, if the party can prove fraud or satisfy the Court that the conditions, as printed on the face of the ticket, were not clear or were misleading, he will succeed.

To summarise, in such cases,

(1) where the party receiving a written or printed document knew the conditions contained in the document, he will be bound by it;

(2) if he did not know of the writings contained in the document but the opposite party had given sufficient notice to him that the document contained such conditions, the receiver will be bound by it; and

(3) if the document with conditions was handed after the contract was completed, it would not be binding at all.

The notice as to these special conditions must be given on the face of the ticket by printing in such a manner as to give reasonable notice on the face of it as to the conditions at the back of the document.

ILLUSTRATION

In one case where the ticket bore the words printed in red letters on the face of it to the effect that the same was issued subject to the conditions at the back, it

was held that it was no excuse that the conditions were in the French language because the plaintiff had sufficient notice as to the conditions and it was his duty to make himself acquainted with them.¹³

The acceptance of a document without protest amounts to a tacit acceptance of the conditions assuming them to relate to the matter of the contract, and to be of more or less usual kind.¹⁴ But any conditions contained merely on a voucher or receipt for the payment of money will not be binding on the person receiving the voucher or receipt.¹⁵

Cross Offers

A offers to sell a particular commodity to B. Ignorant of this offer by A, B sends an offer to buy the identical commodity from A on the same day. Both these letters cross each other in the post. It was held that the two letters were only cross offers and neither of the two can be called an acceptance of the other and therefore there was no contract.¹⁶

Continuous or Standing Offer

If an offer is given to supply a certain class of goods within the year at a certain price upto a certain quantity, or even upto any quantity ordered, it is not an agreement but only a standing or continuous offer. The agreement is brought into existence every time the other side orders quantities at that price and thus accepts the offer.

ILLUSTRATION

When A agrees to supply coal to B at a certain price upto a certain quantity which may be required during the year it is not a contract but a standing offer unless B binds himself to take a certain quantity. A can withdraw his offer otherwise for the quantity that may not have been ordered at the time. If, however, B undertakes not to send orders for coal to any other person than A during the year, there is a binding contract. Another example of a standing offer is a "promise" by a banker to discount a person's bills of exchange upto certain limit.

Promise To Wait

With regard to an offer or proposal it sometimes happens that the proposer prescribes a particular date on or before which his

¹³ *Mackillican v. Compagnie de Messageries Maritimes de France* (1889) 6 Cal. 227

¹⁴ *Giband v. G.E.R. Co.* (1920) 3 K. B. 689

¹⁵ *Chapleton v. Barry* (1940) K.B. 532

¹⁶ *Tinn v. Hoffman & Co.*, (1873) 29 L. T. Ex. 271

offer may be accepted. Such a *promise to wait* is, however, not binding on the proposer unless he gets some benefit, *i.e.*, consideration for keeping the offer open, and may be withdrawn before the expiration of the time promised.

ILLUSTRATION

A has a horse to sell and offers it for sale to B for Rs 800, promising at the same time that he would wait for two days. Before the expiry of these two days, A meets C to whom he offers the same horse and C accepts the offer, takes the horse, and pays the money. A immediately communicates to B his revocation and if that revocation reaches B before B accepts the original offer, A's act is quite in order, but if B has posted his letter of acceptance before receiving A's revocation, B's acceptance is binding on A, and A will have sold his horse twice over, and he will have to pay damages to one of the parties for not keeping the contract.

Revocation of Proposal

A proposal may be revoked at any time before the communication of its acceptance is complete as against the proposer but not afterwards (S. 5).

ILLUSTRATION

If A proposes by letter sent by post, to sell his house to B and B posts his letter of acceptance. A may revoke his offer provided it reaches B before B posts his letter of acceptance but not afterwards.

The revocation of an offer or proposal may be made in one or more of the following ways according to Section 6 of the Contract Act:

- (1) By communication of notice of revocation by the proposer to the other party.
- (2) By the lapse of the time prescribed in the proposal for its acceptance or, where no such time is prescribed, by lapse of a reasonable time, without communication of the acceptance. For example, where an allotment of shares was made on 23rd November of an application made on 28th June it was held that the offer had lapsed as it was not accepted within a reasonable time.
- (3) By the failure of the acceptor to fulfil a condition precedent to acceptance.
- (4) By death or insanity of the proposer, if the fact of his death or insanity comes to the knowledge of the acceptor before acceptance. In *English Law* the death of either party before acceptance causes the offer to lapse and supervening (subsequent) insanity of the proposer does not revoke the proposal as there a lunatic's agreement is voidable and not void.

The *revocation of a proposal* is complete only when the person to whom it is made comes to know of it before accepting it, but as against the person who makes it, when it is put into a course of transmission to the person to whom it is made so as to put it out of the power of the person who makes it (Ss. 4 & 5). This is because the person who has made an offer must be considered as continuously making it until he has brought to the knowledge of the person to whom it was made that he has withdrawn it. For example, *A* revokes his proposal by telegram. The revocation is complete against *A* when the telegram is despatched. It is complete as against *B* when *B* receives it, provided of course *B* receives it before or at the moment he posts his letter of acceptance but not afterwards.

To put it briefly, an offer may be revoked at any time before acceptance.

ACCEPTANCE

Definition of Acceptance

When the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted. A proposal when accepted becomes a contract [S. 2(b)]. Thus the offeree's assent is the manifestation of acceptance.

Who May Accept

Acceptance must be by the offeree *i.e.*, only the person to whom the offer is made may accept it. The principle is plain, for no man can give himself a contractual right by interposing in an offer which was not intended for him.

ILLUSTRATION

In *Boulton v. Jones*¹⁷ *A* sent an order to *B* with whom he had an account and a right of set off. *C* who had just then taken over *B*'s business got the letter addressed to the old firm, accepted the offer and sent the goods, without informing *A* that the firm had changed hands. *B* sued for the price of the goods but *A* refused to pay on the ground that he had sent the order to *B* with the intention of setting off the debt due by *B* against the price of the goods. Held that there was no contract.

Essentials of a Valid Acceptance

(1) **Acceptance Must be Communicated:** Just as offers have to be communicated, acceptances also should be communicated because a mere mental acceptance is no acceptance.

¹⁷ (1857) 157 ER 232; 115 R.R. 695

The communication of an acceptance is complete.

- (a) as against the proposer, when it is put in a course of transmission to him, so as to be out of the power of the acceptor;
- (b) as against the acceptor as soon as it comes to the knowledge of the proposer (S. 4).

When the agreement is made between parties *in each other's presence* the acceptance is communicated *immediately* it is made and both parties are bound at the same time but agreements are now often made by correspondence through the post, by telegram, cable, telex and telephone.

ILLUSTRATION

A makes an offer or proposal to B by a letter sent by post to sell a house to B at a certain price. The communication of the proposal is complete as soon as the letter reaches B. If B wishes to accept this proposal and replies by letter accepting it, this acceptance becomes complete and binding on B, the acceptor, as soon as the letter reaches A, the proposer. It becomes binding on A, the proposer, when it is put in a course of transmission to A, so as to be out of the power of B. Thus it will be seen that during the time the acceptance is on its way, the receiver, *i.e.* the proposer, is bound but not the sender *i.e.* the acceptor.

In the case of an agreement made by telephone¹⁸ it has been held that the parties are treated in all respects as if they were in each other's presence. An agreement made by teleprinter,¹⁹ however, is not concluded until notice of acceptance is received by the offeror.

Thus the rule of law is that *an agreement is made when the acceptance is communicated*. Communication of acceptance really means that *the offeree has done the requisite thing* as indicated by the offeror.

ILLUSTRATION

If the offeror expected to be informed of the acceptance, there will be no acceptance until he is informed, and "where the circumstances are such that, according to the ordinary usages of mankind, the post might be used as a means of communicating the acceptance of an offer, the acceptance is complete as soon as it is posted"²⁰ and this is so even if the acceptance, though correctly addressed, never reaches the offeror. If the acceptance is misdirected through the fault of the acceptor, it will not be considered to have been regularly put in course of transmission and consequently would not be binding on the proposer, *e.g.* where instead of writing, "Bombay" in the address the acceptor, or his clerk, writes "Madras". But if the proposer himself gave a wrong address and that address was used by the acceptor the acceptance would be regular. It should, however, be noted that delivery of the letter of acceptance into the hands of a postman is not the same thing as posting a letter because it is not the business of a postman to receive

¹⁸ *Bhagwandas v. Messrs Girdharlal Parshottamdas & Co.*, A.I.R. 1966 S.C. 543

¹⁹ *Entores Ltd. v. Miles Far Eastern Corporation*, (1955) 2 A.E.R. 493

²⁰ *Henthorn v. Fraser* (1892), 2 Ch. 27, 33

letters for the post beyond his ordinary duty of collection. When an agreement is made by letters sent by post, the agreement is made at the time and place the letter is posted.²¹

In *Brogden v. Metropolitan Railway Co.*,²² a draft agreement to supply coal was approved by the manager and put in a drawer. Through oversight it remained in the drawer and was never sent to the solicitors for the completion of a formal contract. It was held that since the communication of the acceptance was not made, there was no concluded contract. As we have already seen *a mere mental acceptance is no acceptance* in the eye of the law.

Communication may be Waived by the Offeror

Although it is essential for an acceptance to be communicated to the offeror since this rule is for the benefit of the offeror he may waive such communication to himself. Such waiver may be inferred from the offeror prescribing or authorising or suggesting a mode of acceptance which does not involve actual communication to himself. For instance, if the offeror states, "If you mean to accept my offer inform B or hang out a flag, or fire a gun",—in all these cases if the offeree acts accordingly, the acceptance in the manner authorised turns it into a contract, irrespective of the offeror's actual knowledge of such acceptance. We have already seen how in *Carlill v. Carbolic Smoke Ball Co's* case²³ the company was deemed to have waived its right to communication of acceptance by indicating what the offeree should do and hence performance of the prescribed conditions was held to amount to a valid acceptance.

It must, however, be remembered that, *silence cannot be prescribed as the mode of acceptance.*²⁴

ILLUSTRATION

When A says to B, "If I do not hear from you by the end of the week, I shall take it that you have accepted my offer" no acceptance can be assumed by the silence of the offeree because otherwise the offeree would unnecessarily be compelled to reply even when he does not wish to enter into a contract.

(2) Acceptance must be Absolute and Unqualified: An acceptance in order to be binding must be absolute and unqualified and according to the exact terms of the offer. There are four circumstances under which a purported acceptance will not be binding.

(a) Acceptance with variation of terms

(b) Acceptance with addition of terms

²¹ *Kamivetti Subbiah v. Katha Venkataswamy* (1903) 27 Mad., 355

²² (1877) 2 AC 666

²³ (1893) 1 Q.B. 256

²⁴ *Felthouse v. Bindley* 11 C.B., N.S. 869

- (c) Acceptance subject to a formal document
- (d) Grumbling assent.

(a) *Acceptance with variation of terms*: A variation from the terms of the offer, however slight, will not give rise to a contract and may amount to a mere counter offer which the original offeror may or may not accept.

ILLUSTRATIONS

If *A* offers to purchase certain goods from *B*, delivery to be given on April 7 and *B* writes back saying that he will deliver the goods on April 14 there is no concluded contract because *B*'s letter, having varied the terms of the offer, is to be regarded as a mere counter offer and not an acceptance of the original offer.²⁵ Similarly, if *A* says to *B*, "I offer to sell my car for Rs 5,000", and *B* replies, "I will purchase it for Rs 4,500" there is no acceptance but only a counter offer.²⁶

However, a mere variation in the language which does not involve any difference in substance will not matter.²⁷

In one case an offer or proposal was sent for "good" barley by *A*, and *B* accepted the offer in the identical terms, but used the word "fine" barley instead of "good" barley, in his letter of acceptance: it was proved that the expressions "good" and "fine" barley respectively stood for two different qualities: it was held that the acceptance was not an acceptance of that which was offered. On the same principle if the offer states that the goods should be delivered at a particular place, delivery at some other place is no performance of the agreement. In one case *A* offered to sell land for £280. *B* replied accepting the offer and enclosing a cheque for £80 promising to pay the balance by monthly instalments of £50. It was held that there was no contract because the offer of *A* was not accepted in an unqualified manner.²⁸

(b) *Acceptance with addition of terms*: Where the offer is purported to be accepted but fresh terms are added, it is no acceptance and therefore no contract until the additional terms are agreed to by the offeror.²⁹ For example acceptance with the addition of a date for payment was held to be no acceptance.³⁰

(c) *Acceptance subject to a formal document*: Sometimes the acceptance is accompanied by a statement that the acceptor desires the offer to be put some formal shape. This will not of itself render the agreement already made unenforceable – the question is one of intention – if the intention is that the agreement shall ultimately be

²⁵ *Jorden v. Norton* (1838) 150 E. R. 1382; 51 R. R. 508

²⁶ *Union of India v. Babulal A. I. R.* (1968) Bom. 294

²⁷ *Heyworth v. Knight* (1864) 144 E. R. 120; 142 R. R. 855

²⁸ *Neale v. Merrett* (1930) W. N. 189

²⁹ *Sree Meenakshi Mills Ltd, Madura v. Anantarama Iyer* (1930) Madura 654

³⁰ *Neale v. Merrett* (1930) W. N. 189

reduced to writing and that it shall not be binding until that has been done e.g. "this agreement is made subject to the preparation and execution of a formal contract," there is no contract until the agreement has been put into writing. If, however, the intention is merely to preserve a memorandum of an agreement already verbally made, there is a contract as soon as all the terms which are to be put into writing are agreed upon.

It may be noted here that when, after an offer and acceptance, either by word of mouth or by writing, an additional formal agreement in writing is entered into by businessmen in a separate document signed by the parties, the formal agreement becomes the agreement of the parties, but if no such formal agreement is entered into, the offer and acceptance and all other negotiations leading to the acceptance remain the evidence of agreement between the parties. But where there is a formal agreement made and signed, all correspondence that may have taken place before the signing of the formal agreement will cease to be operative and cannot be brought into evidence in case of dispute, but the parties will have to fight their case on the construction of the language of the formal agreement. In other words the formal agreement in such a case becomes the final agreement of the parties in the eyes of law.

(d) *Grumbling assent*: According to Pollock,³¹ where the acceptor grumbles at the terms of the offer but nevertheless accepts, such grumbling assent will be a good acceptance provided the dissatisfaction stops short of dissent.

(3) **Acceptance must be in an Usual and Reasonable Manner**: Section 7 (2) further lays down that the acceptance should be expressed in some "usual and reasonable manner" and it further states that if the proposer "prescribes the manner in which it is to be accepted" then the acceptance must be made in that manner.

ILLUSTRATION

If a proposal is received through the post in the usual course it will be taken for granted that the acceptance in the "usual and reasonable manner" may be made by a letter in reply, through the post, within a reasonable time. If, on the other hand, the proposer in this letter has asked for an acceptance by wire, the "prescribed manner in which it should be accepted", is by wire but if the proposer does not insist within a reasonable time that the proposal should be accepted in the prescribed manner, the proposer is bound by the acceptance made in any usual or reasonable manner.

In short, the acceptance should be either,

(1) In the *prescribed manner*, or

³¹ Pollock on *Contract*, page 10.

- (2) If the offeror has not prescribed either expressly or impliedly, any mode of acceptance, then in the *usual and reasonable manner*.

(4) **Acceptance Must be within a Reasonable Time:** If the proposer has prescribed a time within which the offer should be accepted it must be accepted within the prescribed time otherwise there will be no contract. *If no time for acceptance is stipulated*, the offer must be accepted *within a reasonable time*, otherwise the proposal lapses, *i.e.*, ceases to be of any further effect and cannot be accepted thereafter.

What is a reasonable time is a question of fact and would depend upon the circumstances of each case.

In short, the acceptance must be either,

- (1) Within the prescribed time, if any, or
- (2) Within a reasonable time.

(5) **Acceptance Must be After An Offer:** There can be no acceptance without an offer. For example, an allotment of shares will not be valid if it is made before the allottee has applied for them.

(6) **Acceptance Must be Before the Offer Lapses or is Terminated:** Acceptance can only be of an existing offer. Therefore if an offer has already lapsed or been revoked or rejected a subsequent acceptance will be of no effect.

We have already seen how an offer lapses or is revoked. We shall now see how an acceptance may be revoked.

Revocation of Acceptance

The revocation of an acceptance may be at any time before the communication of the acceptance is complete as against the acceptor but not afterwards (S.5).

ILLUSTRATION

A proposes by a letter sent by post, to sell his house to B, B accepts the proposal by letter sent by post. B may revoke his acceptance at any time before or at the moment when the letter communicating it reaches A, but not afterwards. In other words, B may revoke his acceptance by a telegram and such a revocation is binding on him, B, when the telegram is despatched and against A when the telegram reaches him before the letter of acceptance.

In *English Law*, however, an acceptance is irrevocable and therefore there can be no revocation of an acceptance even though the telegram of revocation reaches the proposer before the acceptance arrives.

SUMMARY

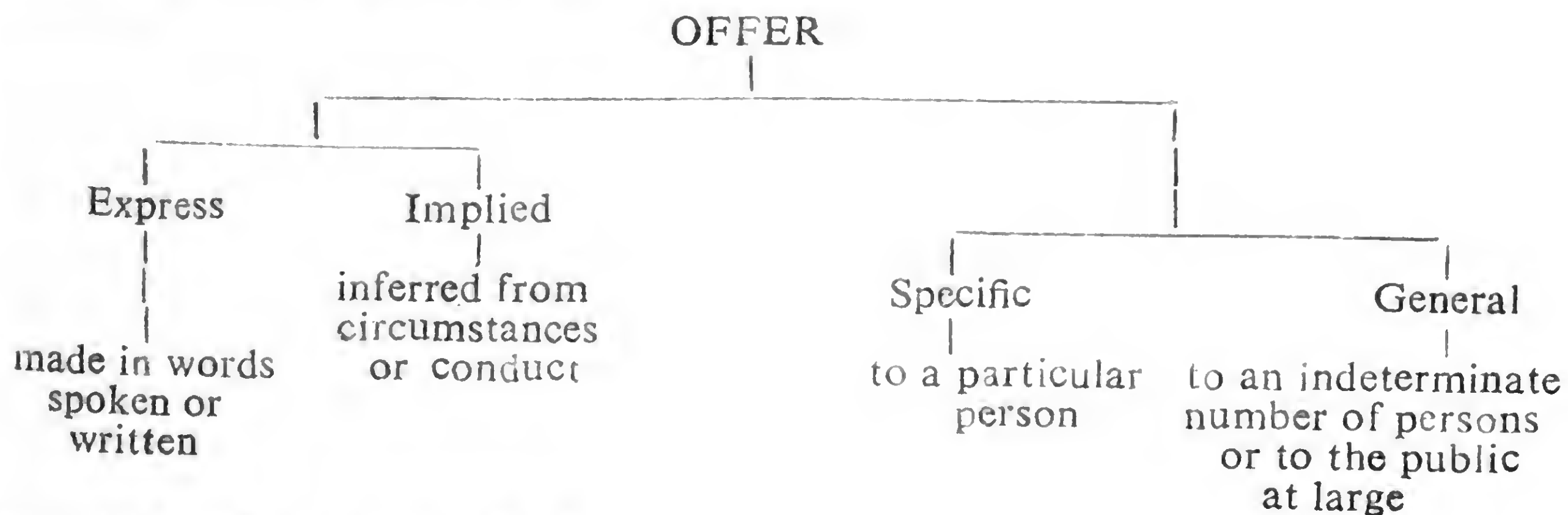
Offer + Acceptance = Agreement

OFFER OR PROPOSAL

Definition of Offer or Proposal: The Indian Contract Act defines a proposal in the following words:

“When one person signifies to another his willingness to do or to abstain from doing anything, with a view to obtaining the assent of that other to such act or abstinence he is said to make a proposal” [S. 2(a)].

Classification of Offer or Proposal



Essentials of A Valid Offer

1. It must be made with a view to obtain an acceptance.
2. It must be intended to enter into legal relations with the offeree.
3. It must be certain and not vague or ambiguous or capable of being made certain.
4. It must be communicated to the offeree.

Special Conditions

1. If the other party knows of the special terms he will be bound.
2. If he does not know, they must be brought to his notice.
3. If a document is handed over after the contract is complete the person receiving it will not be bound by any special conditions in it.
4. Any conditions merely stated in a voucher or receipt will not be binding on the receiver.

Cross Offers

When two identical offers are made by two persons to each other and they cross each other in the post, neither of them can be regarded as an acceptance of the other so that there is no contract. They are only cross offers.

Continuous or Standing Offer

An offer to supply a certain type of goods during a particular period at a certain rate is not an agreement but a standing offer. The agreement is brought about every time a specific order is placed, the order being the acceptance.

Promise to Wait

Where the proposer promises to wait for the acceptance up to a particular date, he is not bound to wait unless he has received some consideration for that promise. He may withdraw the offer before the date mentioned but he will be bound by an acceptance made before the prescribed date if he does not communicate his revocation in time.

Revocation of Proposal

1. By communication of notice of revocation of the offer to the offeree.
2. By lapse of the prescribed time.
3. By lapse of a reasonable time when no time has been prescribed.
4. By not being accepted according to the prescribed or usual mode.
5. By non-fulfilment of a condition precedent to acceptance.
6. By death or insanity of the offeror provided the offeree comes to know of it before acceptance.

ACCEPTANCE

Definition of Acceptance: The Indian Contract Act defines an acceptance in the following words:

“When the person to whom the proposal is made signifies his acceptance thereto, the proposal is said to be accepted” [S. 2 (b)]

Thus it is when the offeree communicates his assent to the offeror that the offer is said to be accepted.

Who May Accept: Only the person to whom the offer is made may accept it.

Essentials of a Valid Acceptance:

1. *Acceptance must be communicated*

A mere mental acceptance is no acceptance therefore in order to enter into a binding agreement the offeree must communicate his acceptance.

According to the Indian Contract Act, “the communication of acceptance is complete,

- (a) *as against the proposer*, when it is put in a course of transmission to him, so as to be out of the power of the acceptor;
- (b) *as against the acceptor*, as soon as it comes to the knowledge of the proposer (S. 4)".

In other words,

- (a) The proposer is bound by the acceptance as soon as the acceptance is sent by the offeree but
- (b) The acceptor is only bound by his acceptance when it reaches the proposer.

Communication of Acceptance May be Waived by the Offeror

The rule which requires an acceptance to be communicated is for the benefit of the offeror; therefore he may waive (give up) this right.

The offeror will be deemed to have impliedly waived his right to communication of the acceptance if he indicates any other particular mode of acceptance.

2. Acceptance must be *absolute and unqualified* and in accordance with the exact terms of the offer.

Examples of qualified acceptance:

- (a) Acceptance with a variation.
 - (b) Acceptance with addition of terms.
 - (c) Acceptance subject to a formal document.
3. Acceptance must be *after* an offer and not before the offer is made,
 4. Acceptance must be *before* the offer lapses or is terminated.

Revocation of Acceptance:

An Acceptance may be revoked at any time before the communication of the acceptance is complete as against the acceptor but not afterwards (S. 5).

TYPICAL QUESTIONS

1. Write notes on:
Offer, Invitation for an Offer and Standing Offer.
2. "Offer creates no legal rights until acceptance but may lapse or be revoked."
Discuss briefly the law as to lapse and revocation of offers.
3. (a) *A*, a smoker, saw a pipe in the shop window of *B*, a tobacconist, marked "cash price Rs 30". *A* enters the shop, puts Rs 30 on the counter and demands the pipe. *B* refused delivery and handed back Rs 30 to *A*. — Discuss.

(b) *C* advertised in a newspaper that he would pay Rs 100 for the supply of certain information. *D* supplied the information. Can he claim the Rs 100.

(i) if he has read the advertisement?

(ii) if he had no knowledge of the advertisement?

4. *B* offered a house for sale. *X* offered to buy it for Rs 5,000. *B* replied: "As you know I paid Rs 5,250 for it, I think your offer is a bit of cheek but I will accept Rs 6,000 for a quick sale". *X* wrote: "I will buy your house for Rs 6,000. Please let my solicitors see the title deeds". *B* replied: "My last letter was not intended to be an offer but an invitation to you to make an offer. I do not accept your offer". What are the rights of *X*?

5. When is communication and acceptance of a proposal complete? Can acceptance be made without express communication?

6. Jones is thinking of buying Smith's car. Smith says to Jones on Monday "I shall definitely keep my offer open to sell you the car for £ 150 until Thursday evening". On Thursday morning, Jones receives a letter from Smith saying that: Smith has changed his mind and now wants £ 175. Jones rings up Smith and says that he will buy the car for £ 150. Is there a contract between Smith and Jones? Give reasons.

7. Your firm telegraphs to Jones: "Will you sell us your Coventry factory? Telegraph lowest cash price". Jones replies: "Lowest price for Coventry factory £ 5,500". Your firm telegraphs: "We agree to buy your Coventry factory for £ 5,500 quoted by you". Is there a complete contract?

8. *D* writes to *E* a letter offering to sell *E* certain goods for £ 40 and asking *E* to reply by post. On receipt of the letter, *E* writes a reply accepting *D*'s offer and posts it. The letter never reaches *D*, who after waiting three days sells the goods to *F*. Has *E* any remedy against *D*?

9. How far is actual "Mental knowledge" necessary in (a) Offer, (b) Acceptance of an offer, (c) Revocation of an offer?

10. When can an acceptance be revoked? *A* proposes, by letter, to sell a house to *B* at a certain price. *B* accepts *A*'s proposal by a letter, sent by post. *B* afterwards revokes his acceptance by telegram which is received by *A* after receipt of the letter of acceptance. Is there any contract? Will it make any difference to your answer if *A* had received the revocation before the acceptance reached him?

11. (a) How is an offer made, revoked and accepted? What rules apply when an offer is made through the Post Office and over the telephone?

(b) *A* promises to purchase from *B* all of *B*'s glass jars at Rs 2 per jar, and *B* promises to sell all that *A* wants at that price. Before *A* places any order for the year, *B* withdraws his promise and *A* sues him for breach of contract. Advise *B*.

12. A mere mental acceptance not evidenced by words or conduct is in the eyes of law no acceptance. Comment.

Chapter 5

CONTRACTS

Free Consent

THE ESSENCE of every agreement is that there ought to be free consent on both sides. Here both the parties must agree upon the same thing, in the same sense.¹ For example, if two persons enter into an agreement concerning a particular person or ship and it turns out that, misguided by a similarity of name, each had a different person or ship in mind, no contract would exist between them.²

Section 14 of the Indian Contract Act lays down rules which state that there cannot be free consent where there has been—

- (1) coercion according to Section 15,
- (2) undue influence according to Section 16,
- (3) misrepresentation according to Section 18,
- (4) fraud according to Section 17, or
- (5) mistake of certain types, as laid down in Sections 20, 21 and 22.

We shall now deal with each of these in detail.

¹ S. 13

² *Raffles Wichelhaus* (1864), 2H, & C 906

1. COERCION ✓

Definition

Coercion is defined by Section 15 of the Act as the committing, or threatening to commit, any of the acts forbidden by the Indian Penal Code, or the unlawful detaining, or threatening to detain, any property to the prejudice of any person whatever, with the intention of causing any person to enter into an agreement.

From an analysis of the definition any of the following acts would amount to coercion.

1. The committing of any act forbidden by the Indian Penal Code.

ILLUSTRATION

A, by an act amounting to criminal intimidation, causes *B* to enter into an agreement with him.

2. A threat to commit any act forbidden by the Indian Penal Code.

ILLUSTRATION

A threatens to stab *B* if *B* does not sign an agreement to employ *A* as the manager of *B*'s estate. Here it should be noted that the threat could be to the person or property and need not be to a party to the agreement.

3. The unlawful detaining of any property.

ILLUSTRATION

An agent refused to hand over books of account to his principal unless the principal agreed to a settlement of accounts. It was held that the threat amounted to coercion.³

4. An unlawful threat to detain any property.

ILLUSTRATION

A young widow of 13 was forced to adopt a boy by her husband's relatives under threat of preventing the removal for cremation of her husband's body. It was held that the adoption could be set aside since obstructing the removal of a dead body amounted to an offence under Section 297 of the Indian Penal Code.

It is immaterial whether the Indian Penal Code is or is not in force in the place where the coercion is employed.

³ *Muthiar v. Muthu Karuppa* (1927) 50 Mad. 786

ILLUSTRATION

A, on board an English ship on the high seas, causes B to enter into an agreement by an act amounting to criminal intimidation under the Indian Penal Code. A afterwards sues B for breach of contract at Calcutta. A has employed coercion, although his act is not an offence by the law of England, and although Section 506 of the Indian Penal Code was not in force at the time when or place where the act was done.

This definition is wider than the English term "Duress" which is defined by English judges as either actual or threatened violence or illegal imprisonment inflicted or threatened by a party to the contract against the other party or any of his own relatives in whom he may be most interested such as wife, parent or child. It should be noted that in the case of duress the act must be against the person and not against property.

2. UNDUE INFLUENCE ✓

"The equitable doctrine of undue influence has grown out of and been developed by the necessity of grappling with insidious forms of spiritual tyranny and with the infinite varieties of fraud."⁴ Its purpose is the protection of weak persons against those who are in a position to dominate their will.

"Undue Influence" is defined by Section 16 of the Act as an influence exercised by one party on the other where the relations subsisting between the parties are such that one of the parties is in a position to dominate the will of the other and uses that position to obtain an unfair advantage over the other.

This is the general rule and the section states further that a person is deemed to be in a position to dominate the will of another where

- (a) he holds a position of real or apparent authority over the other, or
- (b) where he stands in a fiduciary position to the other, or
- (c) where the contract is entered into with a person whose mental capacity is temporarily affected by reason of age, illness or mental or bodily distress.

Our Act in the case of undue influence goes so far as to say that, where to the court the contract seems *unconscionable* and the court finds that one of the parties is in a position to dominate the will of

⁴ Lord Lindley in *Allcard Skinner* (1887) 36 Ch. D. L. 145

the other, the law throws the whole *burden* of proving that such a contract was not induced by undue influence on the person in the dominating position above referred to.

Both in case of coercion and undue influence the contract is *voidable* at the option of the party whose consent was so secured (Ss. 19 and 19A), but if the undue influence is withdrawn, the contract must be avoided within a reasonable time. It should be noted that the plea of undue influence can only be raised between the parties to an agreement and not by a third party.⁵

Undue influence is thus, virtually speaking, moral pressure and will be presumed where there is some relationship between the parties concerned either parental or confidential. Let us take a few instances on the point of undue influence.

ILLUSTRATION

A the father, who has advanced money to his son B during minority, when the son comes of age, by making an unfair use of his parental authority and influence, takes a bond from the son for a much larger amount. In this case A has used undue influence. On the same principle, if a physician who has been treating a patient who has become enfeebled by illness, disease, or age, takes a bond, or enters into an advantageous contract either with regard to his own remuneration, or some other in particular, he will have used undue influence. Similar relationships of confidence and authority would be taken to exist between guardian and ward, solicitor and client, spiritual adviser and disciple, trustee and *cestui que trust*, malik and cultivator but no presumption arises between husband and wife, mother and daughter, creditor and debtor, landlord and tenant.

In short, it should be noted that if a person wishes to plead undue influence *in defence* of an action brought against him on a contract, it is necessary for him to show, first, that previous to entering upon the contract the other party held a position, or relationship of a nature that would enable him to dominate the will of the other, and secondly, unless the transaction appears unconscionable on the face of it to the court he must lead evidence to that effect and satisfy the court on that head. As soon as he does that, *the burden shifts* on the other party who is in a position to dominate the will, to prove that he did not use that undue influence to induce the other party to enter into the contract. It has been held that the court trying a case of undue influence must consider two things to start with: (1) Are the relations between the parties such that one is in a position to dominate the will of the other? (2) Has the one used that position to obtain an undue advantage over the other? Upon determination of the above two points the question of *onus*

⁵ *Kotumal v. Nur Mohammed*, 1931 Sind. 78

probandi would arise. If the transaction appears to be unconscionable, the burden is on the party in a position of domination.⁶

In the case of duress and coercion, consent is destroyed, whereas in the case of undue influence, consent is induced by improper means.

Unconscionable Transactions

These are transactions which, though not brought about by fraud, are forced upon one party by the other by the unconscionable exercise of the power that the party has on the other.

ILLUSTRATION

Where a creditor who has a debtor under his grip, though the latter being heavily indebted to him, forces him to give an agreement of an extortionate nature on the fresh loan being advanced.

If, however, A applies to a banker for a loan at a time when there is stringency in the money market and the banker declines to make the loan except at an unusually high rate of interest the transaction is in the ordinary course of business, and the contract is not induced by undue influence.

Purdah-nishin Women

The rule of law as to this class of women is that in the case of contracts entered into by them with their husbands, or other persons having some control or influence over them, the burden is on the other side to prove that the documents, to which they assented, were properly read out and *explained* to them, and that they were clearly *understood*.⁷ For this purpose, however, a lady claiming to be *purdah nishin* must prove complete seclusion, irrespective of her being a Hindu or a Mohammedan. If a lady, even though she goes about with her face concealed or sits behind the *purdah*, transacts her own business, arranges for rents from her own tenants and communicates on business affairs with other male outsiders who are not members of her family, she will not come within the legal definition of *purdah-nishin*.⁸

3. MISREPRESENTATION

Misrepresentation is, to state it briefly, any untrue *statement* made by a party to the contract to another, which is a material statement of fact and *not of law* and which *induced the other party* to act upon the statement and enter into the contract. In India a positive assurance

⁶ A. I. R. 1967 S. C. 878, followed [D. B. Lal, J] Smt. Kartari v. Shri Kewal Krishan, 1971 S. L. J. 427

⁷ *Hussaina Bai v. Zohra Bai*, A. I. R. 1960 Madhya Pradesh, 60

⁸ *Mussajee v. Hafiz Boo*, 1906, 33 Cal, 773

as to law would also fall under that heading. Misrepresentation may be either (1) innocent or (2) fraudulent. It is innocent when the party who made that statement honestly believed at that time that it was true, but it turns out afterwards to be false.

The *remedy* for innocent misrepresentation, where no intention to deceive exists, is rescission of the contract and restitution. It must, however, be noted that the party misrepresented *must apply for his remedy in good time*. Such an innocent misrepresentation does not give any right to damages. In this case the fact that the party misrepresented *had the means of discovering the truth* would be a good defence.

Fraudulent misrepresentation is a false statement of fact made wilfully, or knowingly, or without belief in its truth, or recklessly, not caring whether it be true or false, with the intention of inducing him to so act upon it to his detriment.

A mere expression of opinion or “puffing”, i.e. the ordinary exaggeration of business routine, will not be fraud.

ILLUSTRATION .

If a seller says, “I think this bicycle is worth Rs 200”, that will not amount to fraud, even though the statement was knowingly false, but if he says, “I myself paid Rs 200 for it” and that statement is false, it will amount to fraud.

A mere omission, even though such as would give due reason for the setting aside of the contract, is not fraud.*

The injured party in the case of fraud would have the right both of avoiding the contract, i.e. *rescission* and of suing for *damages*.

The *Indian Contract Act* defines misrepresentation in the following terms:

✓ “*Misrepresentation*” means and includes:

- (1) the positive assertion, in a manner not warranted by the information of the person making it, of that which is not true, though he believes it to be true;
- (2) any breach of duty which, without an intent to deceive, gains an advantage to the person committing it, or any one claiming under him, by misleading another to his prejudice or to the prejudice of one claiming under him;
- (3) causing, however innocently, a party to an agreement to make a mistake as to the substance of the thing which is the subject of the agreement (S. 18).

* *Arkwright v. Newbold* (1881), 17 Ch. D. 320

4. FRAUD ✓

Fraud is defined by the Indian Contract Act as follows:

“*Fraud*” means and includes any of the following acts committed by a party to a contract, or with his connivance, or by his agent, with intent to deceive another party thereto or his agent, or to induce him to enter into the contract:

- (1) the suggestion, as to a fact, of that which is not true by one who does not believe it to be true; (*suggestio falsi*).
- (2) the active concealment of a fact by one having knowledge or belief of the fact; (*suppressio veri*).
- (3) a promise made without any intention of performing it;
- (4) any other act fitted to deceive;
- (5) any such act or omission as the law specially declares to be fraudulent (S. 17).

As regards *silence*, it should be noted that mere non-disclosure of facts likely to affect the willingness of the other party to enter into the contract is not fraud. But if the *circumstances* are such that there is a *duty* to speak or if the *silence* is in itself *equal to speech*, it will be regarded as fraud.

ILLUSTRATION

B discovers a vein of ore on *A*'s estate. He adopts means to conceal, and does conceal, the existence of the ore from *A*. Through *A*'s ignorance, *B* is enabled to buy the estate at an undervalue. The contract is voidable at the option of *A*. [S.19 ill. (d)].

Thus normally, there is no obligation to enlighten the promisor. However, in certain contracts a duty is cast on the parties to make a full disclosure of material facts and silence or absence of misrepresentation is not enough. Such contracts are often referred to as “contracts *uberrimae fidei*”. Insurance contracts are examples of such contracts.

Both *misrepresentation* and *fraud* make a contract voidable at the option of the party wronged by the misrepresentation. In the case of fraud, however, the party defrauded gets the additional remedy of suing for damages brought about by such fraud. In the case of innocent misrepresentation the only remedies are rescission and restitution.

It will thus be seen that in order to succeed the party suing on the ground of misrepresentation should *prove*:

- (1) That the mis-statement was that *of fact* and not of law. Though misrepresentation which renders a contract voidable should be, as a general rule, of fact, a deliberate misrepresentation of law, especially by a person better qualified to know the law, can equally be a ground for setting aside the contract.
- (2) That the party who is suing *relied* upon the said mis-statement and was induced to enter into the contract believing it to be true.
- (3) That the said statement was *material* to the contract.
- (4) That the said mis-statement was *made* either *by the party* sought to be charged or by his duly authorized agent.

The mis-statement may have been innocently made, *i.e.*, the party making it may have honestly believed it to be true in which case the remedy of the injured party, as we have seen above, will be rescission of the contract and restitution to the original position *i.e.* the position in which he stood at the time he entered into the contract.

In cases of *fraud* besides proving the above four requirements, it should be further proved that the mis-statement was made deliberately or wilfully by the party with the intention to deceive and that the opposite party was so deceived.

According to the exception to Section 19, it is a good defence to an action for misrepresentation or for fraudulent silence within the meaning of Section 17, if it can be shown that the party whose consent was so caused had the means of discovering the truth with ordinary diligence.

ILLUSTRATION

A, by a misrepresentation, leads *B* erroneously to believe that 500 maunds of indigo are made annually at *A*'s factory. *B* examines the accounts of the factory which shows that only 400 maunds of indigo have been made. After this *B* buys the factory. The contract is not voidable on account of *A*'s misrepresentation [ill (b) to S. 19].

5. EFFECT OF MISTAKE

It often happens that one of the parties to a contract pleads mistake as a ground for setting it aside, because according to him there was not that genuine consent to the agreement which is the essence of every contract. With regard to this it must be borne in mind that mistakes of every description could not be permitted to be used in such a manner without making it impossible for contracts

to be entered into at all. Mistakes as to judgment, or mistakes as to expectation, would not be any ground at all for setting aside the contract. A man, therefore, cannot set aside a contract on the plea that he had expected the market to rise, but has now found out that he was mistaken in his expectation, because the market had actually fallen. In one case where a man bought a stove thinking it was large enough to keep his room warm, but afterwards discovered that it was too small for his purpose and wanted to return the stove and avoid the contract on the ground of mistake, he was not allowed to do so because this was only a mistake as to judgment. Again, a mistake as to any law in India would not be a ground for setting aside a contract; but a mistake as to law not in force in India has the same effect as a mistake of fact (S. 21).

There are, of course, mistakes of such a nature that persons labouring under them are taken not to have used that judgment which every one is supposed to use while entering into a contract and therefore there is an *absence of the genuine consent* which is the essence of every agreement, *i.e.* no *consensus ad idem*.

A mistake may be

1. Bilateral or
2. Unilateral

1. A **Bilateral mistake** is one where *both* the parties are under a mistake.¹³ If such a mistake relates to a matter of *fact* which is *essential* to the agreement there is no contract.

2. A **Unilateral mistake** is one where *one* of the parties but not the other is under a mistake. A unilateral mistake is generally no ground for avoiding the agreement except in certain cases where the mistake is so fundamental that there can be no genuine consent.

The cases in which mistakes can be pleaded to set aside a contract may arise in any of the following ways:

(1) **Mistake as to Matter of Fact:** Where *both* parties to an agreement are under a mistake as to a matter of fact essential to the agreement, the agreement is void, but an erroneous opinion as to the value of the thing which forms the subject-matter of the agreement is not to be deemed a mistake as to a matter of fact (S. 20). Under this rule would fall a mistake as to the *existence* of a thing.

¹⁰ *Namayya v. Union of India*, A.I.R. 1958 Andhra Pradesh 533.

ILLUSTRATION

(a) *A* contracted to sell to *B* a cargo of corn supposed to be on its way to England, whereas unknown to both, the cargo had already been sold at an intermediate port before the day of the contract. The agreement is void.¹¹

(b) *A* agrees to buy from *B* a certain horse. It turns out that the horse was dead at the time of the bargain, although neither party was aware of the fact. The agreement is void [ill. (b) to S. 20].

(c) *A*, being entitled to an estate for the life of *B* agrees to sell it to *C*. *B* was dead at the time of the agreement, but both parties were ignorant of the fact. The agreement is void [ill. (c) to S. 20].

(2) Mistake in Expression of Contract or Intention of Parties: Where the parties in a written contract have made a *common* mistake the result of which is that the said contract does not in fact express the intention of the parties concerned, it is naturally not the agreement of the parties. A very strong case of course has to be made as otherwise the value of writing agreements would be considerably destroyed. The usual result is that such a contract, if the court is satisfied that it does not express the intention of the parties concerned, is declared to be unenforceable. There are cases, however, where the court under its equitable jurisdiction interferes and rectifies the contract: where the position has been created through a mere clerical error apparent on the face of the document itself. There are, however, rare cases where Equity courts, when they are satisfied that the written document does not express the intention of the parties, have interfered but here the position is that the court does not make a new agreement but all that it does is to rectify the error on the same footing as the oral agreement which was originally made before the instrument sought to be rectified because the original contract is inaccurately recorded in the written instrument.

(3) Mistake as to Identity of Persons: Where there is a mistake as to the identity of the person with whom one is contracting. This mistake is material only where the personality of the other party is of importance to the person making the error, and may arise out of either the negligence or the fraud of the other party.

ILLUSTRATION

A was in the habit of entering into contracts with one Brockhurst. Later Brockhurst sold his business to Boulton, unknown to *A*, and *A* in the usual course of his business sent orders to Brockhurst, in reply to which, goods were sent by Boulton, who opened these letters, without explaining that the business had changed hands. It was held, when *A* refused to take up the goods, on knowing of the facts of the change of ownership, that the offer for goods was really sent to Brockhurst, the previous owner, and not to Boulton, the present owner of the business.

¹¹ *Couturier, v. Hastie* (1856). 5. H.L.C. 673

and therefore Boulton could not accept an offer which was never sent to him. As far as *A* was concerned there was a genuine mistake as to the identity of the party with whom he was dealing. This mistake would not have arisen had it not been for the negligence of Boulton in not communicating to *A* the change of the ownership of the firm.¹²

Where a notorious usurer assumed a false name and began to trade, inducing other persons to deal with him, who would not have done so if they had known of his identity, the Court held that here the contract may be repudiated on the ground of mistake as to identity.¹³

This type of mistake as well as mistake as to the identity and quality of the subject-matter as dealt with in the next paragraph are known as "fundamental errors" and fall under Section 13.

(4) **Mistake as to Identity and Quality of Subject-matter:** Where both the parties are mistaken as to the identity of the property which is the *subject-matter* of the contract. In one case *A* agreed to buy of *B* 125 bales of Broach cotton to arrive per *SS. Peerless* from Bombay. There were two ships named *Peerless* sailing from Bombay and *A* had in mind one of these ships, whereas *B* had in mind the other. It was held that as it was a mistake as to the identity of the subject-matter of the supposed contract it was sufficient ground for setting it aside.¹⁴

A mistake as to the *quality* of an article is not material unless it is a mutual mistake, regarding some attribute of the article, without which the article is of an essentially different character from the article in the minds of the parties.

(5) **Mistake as to Nature of Transaction:** Where *one* of the parties was mistaken as to the nature of the transaction. This is the Common Law defence of *non est factum*, i.e., "it is not his deed", available in certain circumstances to a person who has been induced by some trick or fraud to put his name on an instrument thinking it to be of an entirely different nature from what it actually is. If the document was a negotiable instrument the party making the mistake should not have been negligent himself. In one case where a very old and infirm man was made to sign a bill of exchange and where the old man on his enquiry as to the nature of the document was informed that it was a fidelity guarantee bond on behalf of his son, it was held that the old man was mistaken as to the nature of the contract, though not negligent, and, therefore, there was no contract

¹² *Boulton v. Jones*, 2 H. and N. 564

¹³ *Golden v. Street* (1800), 2 O.B., C.A. 641

¹⁴ *Raffles v. Wichelhaus* (1864), 2H. and C. 906

at all.¹⁵ This rule does not apply to a person who signs a contract, intending to do so, although its terms happen to be entirely different from what he believes them to be, because generally a person who signs a contract is bound by its contents whether or not he has read them. This type of mistake also falls under Section 13.

Mistake of Law

All the above cases deal with mistakes of fact. A mistake of law will not afford a defence unless, as we have seen above, it is a mistake as to foreign law (S. 21). The famous maxim of Roman law *ignorantia facti excusat; ignorantia juris non excusat* applies to a limited degree in India because here only a mistake as to the law not in force in India is excused. It does not include any law which is in force in India. If a person when he entered into a contract did so under a mistake of law which was not in force in India, it would have the same effect, as we have already seen, as a mistake of fact. For example, A and B make a contract in the erroneous belief that a particular debt is barred by the Indian law of limitation. The contract is not voidable (ill. to S. 21).

The following are some of the qualifications to the rule that a contract is not voidable merely because it is caused by a mistake of law. They are:

- (1) where the mistake is so *fundamental* that it prevents the formation of any real agreement between the parties;
- (2) where it is a mistake as to the existence of particular *private rights*, e.g., if A agrees to buy a property which already belongs to him but he does not know this, it is an ignorance of private rights and will have the same effect as a mistake of fact;
- (3) where the mistake is as to *foreign law* as already explained above;
- (4) where the other party is in a *fiduciary* relation to the person agreeing;
- (5) where it results in the receipt of money or other property by an Officer of the Court.

Money paid or anything delivered *under a mistake* of fact or of law or under coercion may be recovered and the mere omission to take advantage of the means of knowledge within the reach of the person paying does not disentitle him to recover it.

¹⁵ *Foster Mackinson* (1869), L.R. 4C. P. 704; *Ningawwa v. Byrappa* AIR 1068 S.C. 956

ILLUSTRATIONS.

Where *A* and *B* jointly owe 100 rupees to *C* and *A* alone pays the amount to *C*; *B*, not knowing this fact, pays 100 rupees over again to *C*, *C* is bound to repay the amount. A railway company refuses to deliver up certain goods to the consignee, except upon the payment of an illegal charge for carriage. The consignee pays the sum charged in order to obtain the goods. He is entitled to recover so much of the charge as was illegally excessive (S.72 & ill.).

SUMMARY

When is Consent Not Free: Consent is said to be *not* free when it is obtained through:

- (1) Coercion
- (2) Undue influence
- (3) Fraud
- (4) Misrepresentation
- (5) Mistake.

Effect of Agreement Without Free Consent: An agreement made without free consent is *voidable* at the option of the party whose consent was so obtained.

COERCION

Coercion is when a person who would not have entered into a contract is forced to do so by someone who to the prejudice of any person and with the intention of causing any person to enter into a contract does any of the following:

1. Commits any act forbidden by the Indian Penal Code, or
2. Threatens to commit any act, forbidden by the Indian Penal Code, or
3. Unlawfully detains any property, or
4. Unlawfully threatens to detain, any property.

Coercion

Duress

- | | |
|---|---|
| <ol style="list-style-type: none"> 1. Indian law 2. Much wider. The threat may be to person or to property. 3. By any one. 4. Against any person. | <ol style="list-style-type: none"> 1. English law 2. Actual or threatened violence to the person of another or his wife, parent or child. 3. By a <i>party</i> to the contract. 4. Only against a party to the contract or his wife, parent or child. |
|---|---|

UNDUE INFLUENCE

Essentials

1. One of the parties to the contract must be in a *position to dominate* the will of the other *and*

2. He must have *used* that position to obtain an *unfair advantage* over the other.

Presumption of Undue Influence: Undue influence is presumed to exist in the following cases:

1. Where one party stands in a real or apparent authority over the other or
2. Where he stands in a fiduciary relation to the other, or
3. Where the contract is entered into with a person whose mental capacity is temporarily affected by reason of age, illness or mental or bodily distress.

Burden of Proof: Once the presumption of undue influence is raised the burden of proving that the contract was not induced by undue influence, lies on the party in the dominating position.

Dominating Relationship: The following have been held to be relationships where undue influence will be presumed:

1. Father and son
2. Guardian and Ward
3. Solicitor and client
4. Doctor and Patient
5. Religious preceptor and disciple
6. Trustee and beneficiary

No Presumption of Undue Influence: There is no presumption of undue influence in the following cases:

1. Mother and daughter
2. Husband and wife
3. Landlord and tenant
4. Creditor and debtor

Purdah-nishin Woman: Contracts with purdah-nishin women are presumed to be made under undue influence and are liable to be set aside unless the other party proves that

1. the terms were fully explained to her, and
2. she understood them.

Effect of Undue Influence: A contract made under undue influence is voidable at the option of the weaker person.

Distinction between Coercion and Undue Influence

Coercion

1. Physical force
2. Consent is forced out or destroyed
3. It must arise from (a) committing or threat to commit an offence under the Indian Penal code or (b) detention or threat to detain property unlawfully.

Undue Influence

1. Mental pressure
2. Consent is induced by improper means
3. It must arise out of the domination of the will of one over the other

MISREPRESENTATION

Misrepresentation is an untrue representation of a material fact which induced a party to the contract to give his consent to the contract.

Misrepresentation may be

1. Innocent, or
2. Wilful or deliberate, in which case it is fraud.

Distinction between Misrepresentation and Fraud

Misrepresentation	Fraud
1. Innocent	1. Deliberate or wilful
2. No intention to deceive	2. Intention to deceive
3. Remedy is Rescission only	3. Remedy is both rescission and damages
4. Contract cannot be avoided aggrieved party had the means to discover the truth with ordinary diligence	4. Contract is voidable even though aggrieved party had the means to discover the truth

MISTAKE

Mistakes may be

1. Bilateral where both parties are mistaken or
2. Unilateral where one of the parties is mistaken.

A bilateral mistake makes the agreement void if it is of a matter of fact (not of law) essential to the agreement such as

1. the existence of the subject matter of the agreement or
2. the expression of the contract or
3. the identity of the subject matter or
4. the possibility of performance.

A unilateral mistake is generally no defence unless it is a mistake so fundamental that it affects the foundation of the contract. In certain cases the following unilateral mistakes have been held to avoid a contract.

1. Mistake as to the identity of the other party.
2. Mistake as to the nature of the transaction.

TYPICAL QUESTIONS

1. 'An agreement requires a meeting of the minds'. Comment. Discuss what is 'Free consent' in this connection.
2. Write Short Notes on:
 - (a) Coercion
 - (b) Undue influence
 - (c) Fraud

3. Distinguish between Fraud and Misrepresentation. *A* informs *B* that *A*'s house is free from encumbrances. *B* buys the house. The house was already subject to a mortgage created by *A*. What are the rights of *B*?
4. Distinguish between:
Coercion and undue influence.
5. (a) What do you understand by consent?
(b) Discuss the law as to voidability of agreement without free consent.
6. 'Mistake in the formation of a contract may be mutual or unilateral.' Discuss this statement and explain the cases where such mistakes may avoid the contract.
7. 'To consummate a contract there must be mutuality as well as a meeting of minds of the parties'. Explain and illustrate this statement.
8. Distinguish between innocent misrepresentation and fraud and explain the scope of the remedies that may be claimed when a contract is affected by either of them.
9. A partner of a firm fraudulently endorsed a firm bill to *D* in payment of his private debt. *D* endorsed the bill to *E* who endorses it to *F* who is cognizant of the fraud but is not a party to it. Discuss the rights of *F* (i) if he had paid value to *E*, (ii) if he had not paid any value to *E*.
10. *A* contracted with *B* Corporation to build a number of houses. In calculating the cost of the houses *A* by mistake deducted a particular sum twice over and submitted his estimates accordingly. The Corporation agreed to the figures which are naturally lower than the actual cost. Discuss whether the agreement as it stood when the Corporation affixed its seal is binding.
11. *A* told *B* that he was a buyer of good old rice. *B* showed a sample of good rice to *A* without saying anything. *A* took it to mean that the rice shown was old rice and agreed to buy 200 measures of it at a price which exceeded that of new rice corresponding to the sample. Discuss whether *A* is bound to accept the new rice corresponding to the sample.
12. *A* bought a car from *B* who had no title to it. After *A* used it for several months, the true owner demanded the car. Discuss the rights and liabilities of *A*, *B*, and the owner of the car.

Chapter 6

Contracts Capacity to Contract

Meaning of Capacity to Contract

BY CAPACITY to contract is meant the competence of persons to enter into a binding agreement.

Capacity to contract as we have already seen is one of the elements of a binding agreement. This we gather from the words, "*parties competent to contract*" in Section 10 which reads as follows:

"All agreements are contracts if they are made by the free consent of *parties competent to contract*, for a lawful consideration and with a lawful object, and are not hereby expressly declared to be void."

Who are Competent to Contract

According to Section 11, "Every person is competent to Contract who is of the age of majority according to the law to which he is subject, and who is of sound mind, and is not disqualified from contracting by any law to which he is subject."

From the above we can see that incapacity to contract may arise from:

I. Minority

II. Mental incompetence

III. Status.

We shall now deal with each of these in detail.

I. INCAPACITY DUE TO MINORITY (MINORS)

We have seen from Section 11 that in order to be competent to contract a person should have attained the age of majority according to the law to which he is subject.

The age of majority in Indian law is governed by the Indian Majority Act.¹ According to that Act the age of majority is completion of 18 years. If, however, a guardian has been appointed by a Court of his person or property or both, or his property has been placed under the superintendence of a Court of Wards before that age, the age of majority will be attained on completion of 21 years. A person who has not attained the age of majority is a "minor" in Indian law.

In *England*, the age of majority was recently reduced from 21 to 18 by the Family Law Reform Act, 1969 and the description of a person under the age of majority changed from 'infant' to 'minor'.

Under the Common Law of *England* an infant's contracts were voidable at the option of the infant but by the *Infant's Relief Act* the following types of contracts when entered into with infants are absolutely void:--

- (1) to repay money lent or to be lent;
- (2) to pay for goods supplied or to be supplied which are not necessities; and
- (3) all accounts stated with infants. An account stated is an admission of a sum of money being due from one person to another, e.g. an ordinary I.O.U.

Under the Betting and Loans (Infants) Act, 1892 any agreement made by a person after he comes of age to repay money lent during infancy is void. Thus in *England* all the above mentioned agreements are void, whether they are simple or speciality contracts.

A Minor's Agreement is Void

In *Indian Law* it is now settled that a minor's agreement is absolutely void and not merely voidable.² In that case the mortgagee of a minor's property had filed a suit for the recovery of his

¹ IX of 1875

² *Mohiri Bibi v. Dhurmados Ghose* (1903), 30 Cal. 539

mortgage money and for sale of the property in case of default. It was held by the Privy Council that according to section 11 of the Indian Contract Act, a minor was incompetent to contract and therefore the minor's agreement was void and not merely voidable and that the mortgagee could not recover the mortgage money nor could he have the minor's property sold under his mortgage.

Ratification of Minor's Agreement

The act makes no express provision for ratification by a minor, on attaining his majority, of a contract entered into by him during minority; but as it is now finally decided by the Judicial Committee in *Mohori Bibee v. Dhurmodas Ghose*³ that a *minor's agreement is void* there can be *no ratification* by him on attaining majority, e.g. a promissory note given by a person on attaining majority in settlement or renewal, of another promissory note which he had given during his minority cannot be enforced, as there is no consideration for the second note.⁴ As was observed in *Raj Rani v. Prem Adib*⁵, "No action shall be brought whereby to charge any person upon any ratification made after full age of any promise or contract made during infancy whether there shall or shall not be any new consideration for such promise or ratification after full age.

When, however, a person after attaining majority actually repays a debt incurred during his minority it is not a question of ratification and therefore the sum paid is to be treated as a gift and cannot be sued for.⁶

Minor's Liability for Necessaries

A minor's agreement being absolutely void even an agreement to buy necessaries of life would be void. The reason for making a minor's agreement void was for the protection of young, inexperienced persons from unscrupulous dealers etc., but this would mean that dealers would be reluctant to supply on credit even goods which the minor would actually need. Therefore there is a *quasi-contractual* obligation to pay a *reasonable price* for *necessaries* of life which have *actually* been *supplied* to a minor or to his dependants. This provision is found in Section 68 of the Indian Contract Act:

"If a person incapable of entering into a contract, or anyone whom he is legally bound to support, is supplied by another person, with necessaries suited to his condition in life, the person who has

³ (1903), 39 Cal 539

⁴ *Indrn v. Anthappa*, 16 Mad. L.J. 222

⁵ (1949) AIR. Bom. 215

⁶ *Anant Rai v. Bhagwant Rai* (1939) A.L.J. 935

furnished such supplies is entitled to be reimbursed from *the property* of such incapable person."

The necessities of life depend on the position in life of the infant. Food and clothing may be taken as simple examples of necessities, but that may be extended *according to the station in life of the minor*. The necessities should not only be such as a person in the position of the minor may want for ordinary use; but must also be those which the minor *actually needs*. He cannot actually need things with which he is already abundantly supplied and it is immaterial whether the other party knows this or not. In the case of a young aristocrat, the necessities of life may include a horse, carriage or a motor car, regimental uniforms and decorations, livery and servants suitable to the position in life of the minor. But luxuries such as cigars and jewels are held not to be necessities of life even in the case of a young man of large fortune. In the case of necessities, in India, a minor's property is liable; there is *no personal liability*. Articles of real use will not be considered necessities if they are excessively costly, *e.g.*, a watch is held to be a necessary of life, but its value must have some bearing on the position in life of the infant. Buttons may be a necessary part of clothing but pearl or diamond buttons will not be considered necessities.⁷

It should be further remembered that in strict law an infant is incapable of making a contract of purchase at all and hence there cannot be any liability for goods supplied but as has been laid down in *Nash v. Imman*.⁸ "If a man satisfies the needs of an infant by supplying to him necessities, the law will imply an obligation to repay him for services so rendered and will enforce the obligation against the estate of the infant". Thus it will be seen that it is not exactly a direct liability to pay but a sort of a *quasi-contractual obligation* imposed by law owing to the peculiar nature of the circumstances. Again if an infant enters into a contract to purchase necessities, the said contract will not be binding on him under the Sale of Goods Act, because the Sale of Goods Act clearly states that he would be only liable for necessities sold and delivered to him. The necessities would also include the infant's lodging expense as well as necessities for himself and his wife, medical attendance as well as the funeral expenses for either and actually necessary expenses for travelling and conveyance. If a loan is given to an infant in order to help him to buy necessities or in case necessities are purchased

⁷ *Ryder v. Wombwell* (1868) LR. Ex. 32

⁸ (1903), 2 K.B. p. 1 on page 8

by a third party for him at the infant's request, the infant would be bound to pay just as if he had himself purchased the necessaries.

It has been held that costs incurred in successfully defending a suit on behalf of a minor in which the minor's property was in jeopardy were necessaries⁹ as also costs incurred in defending a minor in a prosecution for dacoity.¹⁰

According to Baron Park in *Peters v. Fleming*¹¹ the truth, as to necessaries is—

“That all such articles as are purely ornamental are not necessaries and are to be rejected because they cannot be requisite for any one; and for such matters, therefore, an infant cannot be made responsible; but if they are not strictly of this description then the question arises whether they are bought for the necessary use of the party in order to support himself properly in the degree, state, and station of life in which he moved. If they were, for such articles the infant may be responsible.”

Certain services rendered to a minor, e.g. education, legal or medical advice can be regarded as necessaries for which the minor's property is liable.

Loans advanced to a minor to pay for necessaries are also recoverable from the minor's estate, if any. There is no personal liability.

The infant or minor would also be bound by an agreement made by him to serve for a wage provided in the opinion of the Court such an agreement was for his *benefit*. In deciding this issue, the Court will take the whole agreement as it stands into consideration and then decide and will not refuse simply because some of the stipulations seem to be unavoidable. The same rule will apply in the case of contracts of *apprenticeship*. If, however, a contract of service is not reasonable and not for the infant's benefit, the Court will refuse to enforce it. If the contract contains stipulations which are unreasonable, being in restraint of trade, the Court will consider whether these objectionable stipulations are severable and, if so, will enforce against the infant the contracts minus the objectionable stipulations. In other words, the Court will reject the objectionable stipulations by separating them from the contract and the rest of the contract will stand good. It has also been said

⁹ *Watkins v Dhunoo Baboo* (1881) 7 Cal, 140

¹⁰ *Sham Charan Mal v. Chowdhry Debya Singh* (1894) 21 Cal. 872

¹¹ (1840), 9 L.J. Ex. 81

that in a case of apprenticeship he can be sued for the payment of a reasonable premium which may have been agreed upon, when he comes of age and also in connection with any reasonable restriction which may have been incorporated in the contract of his apprenticeship to the effect that he would not compete in business after his apprenticeship ceases.

We have learnt that a minor is incompetent "to contract" *i.e.* to be bound by a promise. If, however, a minor gives value without any promise of further performance he is entitled to sue the other party for the performance of that person's promise¹²; so also a minor as well as any other person incompetent to contract may accept a benefit and be a transferee. Thus a duly executed transfer by way of sale or mortgage in favour of a minor who has paid the consideration is valid and enforceable by him or any other person on his behalf. Money advanced by a minor may be recovered by him by suit as he can take the benefit under a contract.

Minor Shareholders

According to *English Law* an infant's agreement to take shares is voidable at the option of the infant, but according to *Indian Law* an agreement by a minor to take shares is void and not voidable. A minor must repudiate his liability on attaining majority and must not by his conduct lead the company to believe that he is a shareholder.¹³ Thus care should be taken not to allot shares or transfer to him shares which are not fully paid, for the simple reason that the infant can repudiate his membership either during his infancy or minority or within a reasonable time after reaching the age of majority. Where an infant or minor repudiates or rescinds his agreement to take shares in a company, he cannot recover the money paid on them, unless there was a total failure of consideration, *e.g.* the shares turned out to be valueless.¹⁴

A minor shareholder, after attaining majority received dividends and did not raise any objection to his name being on the register of members. He was by his conduct estopped from denying that he was a shareholder.¹⁵ This is because on general principles and Equity a minor is not entitled both to repudiate his agreement and to retain specific property which he has acquired under it. Of course, in deciding this issue the question to be answered is

¹² *Bhola Ram v. Bhagat Ram* (1926) 8 Lah. L. J. 539

¹³ *Gadigeppa v. Balagowda* (1913) A. I. R. Bom. 561

¹⁴ *Steinburg v. Scala (Leads) Ltd.* (1923), 2 Ch. 452 C.A.

¹⁵ *Fazalbhoy Jaffer v. The Credit Bank of India* (1914) I.I.R. 39 Bom. 331

whether the agreement was favourable at the time the infant entered into it and not at the time when through a course of subsequent events it is proved to be not to his benefit.

Extent of Minor's Liability in Tort

The infant is liable for his *tort*, *i.e.*, a wrong, unless the tort is in reality a breach of contract. The tort must be separate from and independent of contract otherwise many contracts would be enforced on minors in an indirect manner, *e.g.*, in one case an infant hired a horse for riding and injured it by over-riding. Here the infant had committed a tort, *i.e.*, negligence in the performance of the contract. It was held that "if an infant in the course of doing what he is entitled to do under the contract is guilty of negligence, he cannot be made liable in tort if he is not liable on the contract," for "you cannot convert a contract into a tort to enable you to sue an infant".¹⁶ In another case an infant hired a horse expressly for riding and not for jumping and then he lent it to a friend who jumped the horse and killed it. Here "what was done by the infant was not an abuse of the contract, but was the doing of an act which he was expressly forbidden by the owner to do with the animal" and therefore the infant was held liable for the tort.¹⁷

No Estoppel Against a Minor

Estoppel is a rule of evidence (S. 15, Evidence Act) which prevents a person from denying the truth of what he has once represented if another person has acted on the faith of such representation.

There can be *no estoppel against a minor* and it has been held that a minor who has deceived the other party to the agreement by representing himself as of full age is not prevented from later asserting that he was a minor at the time he entered into the agreement.¹⁸

Circumstances such as a minor's fraudulent representation as to his age may be such that the Court may in its discretion, having regard to Sections 38 & 41 of the Specific Relief Act, require the minor to make compensation, *e.g.*, when a sale or mortgage of a minor's property was set aside he was ordered to make compensa-

¹⁶ *Jennings v. Rundall*, 8 T.R. 335.

¹⁷ *Burnard v. Haggis* (1863), 14 C.B., N.S. 45.

¹⁸ *Sadiq Ali v. Jai Kishore*, 30 B.L.R. 1342.

tion to the lender on the Court being satisfied that the minor had made a fraudulent representation as to his age.¹⁹

Specific Performance of a Minor's Agreement

It has been held that a *minor's agreement* being void, it *cannot be specifically* enforced either by the minor or by the other party to the agreement.²⁰ If, however, it is an agreement to sell but not to buy property entered into by a certified guardian of a minor and if the guardian acts with the leave of the Court such an agreement may be specifically enforced by either party provided the agreement is for the minor's benefit.²¹

Minor Partner

A minor cannot be a partner in a firm as partnership implies a contract and we have learnt that a minor's agreement is void. According to the Indian Partnership Act of 1932, Section 30, a minor may, however, *with the consent of all the partners* for the time being, *be admitted to the benefits of partnership, i.e.,* such a minor will have a right to such share of the property or profits of the firm as may be agreed upon and he would have access to and inspect and copy any of the accounts of the firm. The liability of the minor will, however, be limited to his share in the partnership for acts of the firm, but the minor will *not be personally liable*. The minor partner may sue the other partners for account and payment of his share of the property or profits of the firm only on severing his connection with the firm. At any time within six months of attaining majority or of obtaining knowledge that he had been admitted to the benefits of the partnership, whichever date is later, the minor may give public notice either that he elects to become a partner or not to become a partner. If he fails to give such notice he will be deemed to have become a partner in the firm on the expiry of the said six months.

If he elects to become a partner after attaining majority (1) his rights and liabilities as between himself and the other partners continue as they were during minority up to the date on which he becomes a partner, but (2) he also becomes personally liable to third parties for all acts of the firm done since he was admitted to the benefits of partnership and (3) his share in the property and

¹⁹ *Kamla Prasad v. Sheo Gopal Lal* (1904) 26 All, 342;

Md. Said v. Bishambhar Nath (1903) 45 All. 644.

²⁰ *Sarwarajan v. Fakruddin*, 38 Cal. 232.

²¹ *Innatunnessa v. Janki Nath* (1917) 22 C.W.N. 471.

profits of the firm will be the same as he was entitled to as a minor.

If he elects not to become a partner, (1) his rights and liabilities as between him and the other partners will continue until the date on which he gives public notice, (2) his share will not be liable for any acts of the firm after the date of the notice, and (3) he will be entitled to sue the partners for accounts and for his share of the property and profits.

In *English Law* a minor can on attaining majority repudiate all his liabilities in the firm of which he was a partner during minority, provided he does so within a reasonable time of his attaining majority. It must, however, be a repudiation of the whole of the liability as well as profits and if he has received any profits he must return them. The other difference is that if in *English Law* a minor does not repudiate his partnership on coming of age he is only liable for the firm's debts and losses incurred after his coming of age.

Minor Agent

A minor can be appointed an agent and all contracts entered into by the minor, in the course of such an agency, are binding on the principal. The only position created will be that the principal would be unable to recover any loss or damage from a minor agent for negligence or breach of duty (S. 184).

Minor and Negotiable Instruments

A negotiable instrument can be drawn, made, endorsed or delivered by a minor but in such a case although all other parties will be liable, the minor himself will not be.

Minor and Insolvency

A minor cannot be adjudicated an insolvent, but as to whether he can be adjudicated for necessities supplied to him is, in the opinion of the late Sir Dinshah Mulla a doubtful point.

Liability of Minor's Surety

Although a minor cannot be held liable on a contract a person of the age of majority who has stood surety for him is liable.²² This is because no one would otherwise be willing to deal with a minor.

²² *Kashiba v. Shripat*, 19 Bom. 697

Minor's Marriage Contract

It has been held that if a minor belongs to a community, such as Hindu or Goan, where it is customary for parents to arrange marriage for their children, a contract of marriage entered into by a guardian on behalf of the minor would be valid and an action for breach of it would lie if the contract is for the benefit of the minor.²³

Position of Minor's Guardian

Agreements made by a guardian on behalf of a minor are valid only if they are within the powers of the guardian. The powers of a guardian depend upon the *personal law of the minor* and the provisions of the *Guardian and Wards Act*. For example, the guardian of a minor has no power to bind the minor by a contract for the purchase of immovable property.²⁴ However, a contract entered into by a certified guardian, *i.e.* one appointed by the court, of a minor with the sanction of the court for the sale of the minor's property may be enforced by either party to the contract. Similarly, a contract entered into by the mother of a Hindu minor for the sale of the minor's immovable property in order to pay the ancestral debt can be enforced by either party.²⁵

II. MENTAL INCOMPETENCE OR UNSOUNDNESS OF MIND

We have seen from Section 11 that in order to be competent to contract a person must be of sound mind. *Unsoundness of mind* may arise from lunacy, idiocy, senility or mental decay due to old age, delirium due to high fever, hypnotism or drunkenness.

"A person is said to be of sound mind for the purpose of making a contract if, at the time when he makes it, he is capable of understanding it and of forming a rational judgment as to its effect upon his interests."²⁶

The *test* of sound mind is therefore whether at the time the agreement was made, the party concerned was capable of,

(a) understanding it, and

(b) forming a rational judgment as to its effect upon his own interests.

²³ *Rose Fernandes v. Joseph Gonsalves*, 48 Bom. 673

²⁴ *Mir Samrayan v. Fakrudin* (1912) 1 C 13 331

²⁵ *Subrahmanyam v. Subba Rao* 75 I.A. 115

²⁶ Section 12

Lunatics

A *lunatic* differs from an idiot inasmuch as the latter is hopelessly mad *i.e.* of unsound mind and has no lucid intervals, whereas a lunatic has lucid intervals during which he is perfectly sane. If, therefore, a contract is entered into with a lunatic during his lucid interval, *i.e.* when he was perfectly sane, it is binding on him and his estate would be liable; otherwise the contract is bad. In the language of the Act, "A person who is usually of unsound mind but occasionally of sound mind, may make a contract when he is of sound mind". Thus even a patient in a lunatic asylum, who is at intervals of sound mind, may contract during those intervals.²⁷ But as an idiot has no lucid intervals, he cannot enter into binding contracts at all.

According to *English Law* a lunatic's agreement is *voidable* at the option of the lunatic and not void, and in *England*, if a person enters into an agreement with a lunatic without knowing that the other person was a lunatic, or without having any reason to believe him to be such, the contract is good even though entered into with a lunatic. It is not so in *India*.

In India, a lunatic's agreement is void irrespective of the question whether the mental condition of the lunatic was known to the other side. The value of necessities supplied to idiots and lunatics, however, is recoverable out of their estates.

The above rule is subject to the *exception* that where after an inquisition under the Lunacy Act 1912 in India, or under a similar inquisition in England, a person is *adjudged* a lunatic and a committee is appointed, as long as that order is in force an agreement made even during a lucid interval will not be enforceable.

Drunken or Delirious Persons

If a person is so drunk, intoxicated, or delirious from fever as to be incapable of understanding the nature and effect of an agreement or to form a rational judgment as to its effect on his interests, his condition is similar to that of a lunatic and on the same grounds as in the case of a person of unsound mind he cannot enter into valid contracts whilst such delirium or drunkenness lasts.²⁸ In cases where the contract is sought to be avoided on any of the above grounds the party setting up such a disability must prove it.

²⁷ Section 12, ill. (a)

²⁸ Section 12, ill. (b)

The liability for necessities of life supplied to persons of unsound mind is the same as for minors.

III. INCOMPETENCY DUE TO STATUS

Incompetency may arise from *status*, political, married, professional or corporate.

Political Status

1. **Alien:** An alien or foreigner has full capacity to contract. Under normal conditions and in times of peace, an alien can enter into any contract with an Indian citizen (with a British subject in case of English Law except to acquire an interest in a British ship); but such a contract would be *suspended* during the continuance of hostilities or may be entirely *dissolved* if the intention of the parties cannot substantially be carried out through postponement. In the former case the rights under it are not annulled but revived and could be enforced upon the conclusion of peace. Contracts to deal in partnership and contracts for perishable commodities fall under the latter category. Contracts of partnership are dissolved because a continuous performance during the war would entail intercourse with the enemy.

An *alien enemy* residing in India with the permission of the Central Government may sue in an Indian Court but an alien enemy residing in India without such permission or residing in a foreign country cannot sue in an Indian Court.²⁹ The test of a person being an alien enemy is not his nationality, but the place in which he resides or carries on business.³⁰ In the case of a Corporation or a Joint Stock Company whether it is an enemy company will depend on those *who control and direct it* and not on the jurisdiction under which it is incorporated nor on the nationality of its shareholders.³¹

There are some important decisions to illustrate the principle involved in this connection. In one case, where a company had agreed to give all the products of its mine to alien enemies prior to the out-break of war with their country, it was held that whether the contract involved intercourse with the enemy or not, the contract must be declared dissolved, as the resources of the mine would not

²⁹ C.P.C. Section 83

³⁰ *Porter v. Freudentery* (1915) 1 K.B. 857

³¹ *Oldham Steamship Co.*, (1917) 2 K.B. 639

otherwise be available for the benefit of the country.³² In another contract of a similar nature there was a clause to the effect that, in the case of hostilities its operation may be suspended. But here too the contract was ordered to be dissolved on similar grounds as in the former case.³³

The above two cases were decided on the principle that where a contract is likely to result (1) in intercourse with the enemy during the war, or (2) in preventing the resources for the benefit of the country itself, and thereby indirectly helps the enemy, the contract must be dissolved.

2. **Foreign Sovereigns:** As a general rule, foreign sovereigns and their diplomatic staff *are not subject to the jurisdiction of our Courts*. They can enforce contracts if they choose; but contracts cannot be enforced against them *unless they submit voluntarily to the jurisdiction of our Courts*.³⁴ Once they submit to such jurisdiction they are bound by the Court's order or decree. Ambassadors with full powers are on the same footing as representatives.³⁵

In India, a Foreign State which has been recognized by the Central Government may sue in any Court with a view to enforce a private right vested in the Ruler of such State or in any officer of such State in his public capacity.³⁶ For the purposes of these suits persons may be appointed agents of such Ruler by the Central Government at the request of such Ruler for the purpose of acting on his behalf and prosecuting or defending such suits. A Foreign Ruler or any Ambassador or Envoy of a Foreign State may be sued with the *consent of the Central Government* certified in writing by a Secretary to such Government. This *consent* will only be given if the said Ruler (1) has instituted a suit in the Court against the person desiring to sue him, or (2) by himself or another trades within the local limits of the jurisdiction of the Court, or (3) is in possession of immovable property situate within such limits and is to be sued with reference to such property or for money charged thereon, or (4) has expressly or impliedly waived such privilege.³⁷ This consent must be obtained before the institution of the suit, a consent obtained later is not sufficient and the suit may be dis-

³² *Zinc Corporation v. Hirsch*, (1916) 1 K.B. 541 C.A.

³³ *Ertel Biebr v. Rio Tinto* (1918), A.C. 260

³⁴ *Mighell v. Sultan of Johore* (1894), I.B.Q. 149

³⁵ Diplomatic Privileges Act, 1708

³⁶ C.P.C. Section, 84

³⁷ C.P.C. Sections, 85 and 86

missed or withdrawn with the sanction of the Court with liberty to bring a fresh suit.

Convicts

In *English Law*, persons undergoing a sentence for treason or felony cannot make valid contracts but with regard to those contracts which they had entered into previous to conviction, they may appoint administrators to act on their behalf. A convict is one on whom a sentence of death or penal servitude has been passed by a competent court of jurisdiction on a charge either of treason or felony.³⁸ The disability will cease as soon as the convict has suffered the punishment or in the case of a sentence of death if the said sentence has been lawfully commuted or where he has served the complete term of his servitude for which a judgment has been passed or any substituted punishment or has been pardoned by the Crown or where the sentence is suspended while he is lawfully at large under any licence.

Professional Status

Barristers in England cannot sue for fees due to them for services rendered in the ordinary course of their professional duties. This does not apply to a barrister who is enrolled as an advocate of an Indian High Court on the principle that as an advocate the Law to which he is subject is the Law of the bar where he is practising.³⁹ Formerly the same law applied to physicians but now a physician can sue for his fees.

It may be added that in the case of physicians, certain Colleges of Physicians prohibit by bye-laws their members from suing for their fees, charges and expenses.

Married Status

According to the Common Law of England on the principle that husband and wife are one person, a married woman was incapable personally of holding or acquiring property and could not make contracts. The Married Women's Property Act, 1882, introduced the doctrine of "separate property" by which a married woman was entitled to hold and dispose of property and to enter into contracts but there was no personal liability as only her "separate property" was answerable for her debts. Now, after the

³⁸ *In re J* (1909), I. Ch, 574 on Page 577

³⁹ *Nithal Chand v. Dilawar*, A.I.R. 1933, All 417 F.B.

passing of the 1935 Act, in England the doctrine of "separate property" is abolished and a married woman is to be treated in all respects as if she were a *feme sole i.e.* she now has the same contractual capacity as an unmarried woman or a man. Thus she can even be made a bankrupt.

A woman in Indian law is under no disability by reason of her sex from entering into a contract neither is her capacity to contract affected by her marriage either under the Hindu or Mohammedan law.

A Hindu married woman can enter into contracts and bind her "Stridhan". Her contracts would bind her husband only if they are for her necessities or are made with her husband's consent or authority in which case she would be regarded as his agent. A Mohammedan married woman stands on the same footing in connection with her capacity to enter into contracts. The women of other communities are given the same power of holding separate property by Section 20 of the Indian Succession Act of 1925 and Section 4 of the Married Women's Property Act 1874. The husband is bound to support his wife according to the station in life in which he himself is. If, therefore, a husband refuses to support his wife, whether European, Hindu, Mohammedan or Parsi, she can enter into contracts for the supply of necessities and make her husband pay for them. On the other hand, if the wife leaves her husband's protection of her own accord or has been given a special allowance she loses the right to pledge his credit.

Corporate Status

A corporation is *defined* as an artificial person, created by law, with a perpetual succession and a common seal. The *contractual capacity of a Corporation* is limited by two factors:—

- (1) Being an artificial and not a natural person it can act only through an agent and cannot enter into contracts of a strictly personal nature *e.g.*, a corporation cannot be a doctor, lawyer or accountant, and
- (2) Being formed by Royal Charter, Act of Parliament, etc., its powers are limited by the Charter or Statute under which it is formed *e.g.*, the contractual capacity of a company formed under the Companies Act of 1956 is limited by the terms of its memorandum and articles of association.

In all contracts entered into by corporations, specially trading corporations, which are in the daily and usual course of the business of the corporation and of frequent occurrence, the *common seal* of the corporation may be dispensed with and instead, the duly authorised agent of the company may sign on its behalf. In the case of unusual contracts and contracts of importance, the seal of the company must be affixed. The contractual capacity itself in the case of corporations depends, in each case, on the mode of their creation and the purpose for which they are created. The charter or the memorandum and the articles of association of every corporation would be the guiding instruments in that regard. Thus if a corporation enters into an agreement which is beyond the scope of its memorandum, deed or charter, such an agreement is *ultra vires* the corporation and therefore void.

The agent who signs on behalf of the corporation must make it clear that he is signing only as an agent of the company, *e.g.*, "For the Bank of Bombay, J. Begbie, Secretary", would be the correct signature as it clearly indicates that Mr. Begbie signs as an agent of the Bank.

If, on the other hand he were to sign as

J. Begbie,

Secretary, Bank of Bombay,

he would be taken to have signed for himself and not on behalf of the Bank.

SUMMARY

One of the essentials of a valid agreement is that the parties to the agreement must have the capacity to be bound by it.

Incapacity to contract may arise out of

1. Minority
2. Mental deficiency
3. Status

1. Minority

A minor's agreement is void.

If a minor or anyone dependant on a minor is supplied with necessities of life, such minor's property, if any, is liable for a reasonable price to the supplier. There is no personal liability. This is a quasi-contractual obligation.

Minor's legal Position re contracts

- (i) A minor's agreement is void.
- (ii) A minor's property, if any, is liable for necessities of life actually supplied to the minor or to his dependants.
- (iii) A minor can be a promisee *i.e.*, he can take a benefit under a contract though he cannot be bound by it.
- (iv) There can be no ratification of a minor's agreement.
- (v) There can be no estoppel against a minor.
- (vi) A minor can be an agent so as to bind his principal.
- (vii) A minor cannot be a partner because partnership arises from contract but a minor may be admitted to the benefits of partnership with the consent of all the partners.
- (viii) An agreement made by the guardian of a minor is valid only if such an agreement is within the powers of the guardian.
- (ix) A minor cannot be adjudicated an insolvent.
- (x) If a minor has signed a negotiable instrument he will not be liable on it but other persons whose signatures appear on the instrument will be liable *i.e.*, the negotiable instrument will not be invalid merely because a minor has signed it.
- (xi) If a minor jointly undertakes liability on a contract with a person of full age the minor will not be liable but his joint promisor may be held liable.
- (xii) A minor's surety is liable though the minor may not be held liable in the contract.

2. Mental Incompetence or Unsoundness of Mind

Mental incompetence may arise from insanity (lunacy or idiocy), senility, delirium through fever or extreme drunkenness.

A lunatic's agreements are void but if it is proved that the agreement was made during a lucid interval, the agreement will be valid. An agreement with an adjudged lunatic is void, even if made during a lucid interval.

A duly appointed guardian of a lunatic can bind the estate of the lunatic. The effect of agreements with persons of unsound mind is that such agreements are void.

If a person of unsound mind or his dependant is supplied with necessities of life, a *quasi-contractual* obligation is created to pay a reasonable price out of the estate, if any, of such person. There is no personal liability.

3. Incompetence through Status

An *alien* is a person who is the citizen of a foreign country. Agreements with aliens during war are void. If war breaks out after the agreement is entered into it may be either dissolved or merely

suspended. Statutory bodies such as municipal corporations cannot enter into valid agreement, which are outside the powers given by the statute.

Incorporated companies cannot enter into valid agreements which are *ultra vires* the Memorandum of Association.

Married women are not disqualified from entering into contracts.

TYPICAL QUESTIONS

1. Who can enter into contracts? State the essentials of a valid contract in brief.
2. 'Every person is not competent to enter into a valid contract'. What do you deduce from this statement?
3. A minor is incompetent to enter into a contract. But a minor can be appointed as an agent. How do you explain this?
4. (a) Can a minor enter into a valid contract? If not, state the reasons.
(b) *A*, being a minor, holds himself out as a major and executes a deed in favour of *B*. *B* realised later that *A* was in fact a minor and thus he was duped. *B* files a suit against *A* for recovery of money under the contract. *A* pleads his minority in defence. Explain whether this plea is sustainable in law.
5. *A*, a minor borrowed Rs 1,000 from *B* on a fraudulent representation that he was a major. Can *B* sue for the return of amount?
6. *A*, a minor, fraudulently represents himself to be a major and takes delivery of a car, executing a promissory note in favour of the dealer, *S*. *A* fails to pay as per the note. Can *S* recover the car from *A* or sue him on the basis of the promissory note?
7. Who is competent to contract? Enumerate the effect of an incompetent party to a contract.
8. Can the following enter into agreement.
 - (i) A minor
 - (ii) A lunatic
 - (iii) A married woman
 - (iv) A corporation

Chapter 7

CONTRACTS

Consideration

Definition of Consideration

CONSIDERATION IS 'which for what', '*quid pro quo*', something that a person gives for something he receives.

Consideration is *defined* by the Indian Contract Act as:—

“When at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing, or promises to do or to abstain from doing, something, such act of abstinence or promise is called a consideration for the promise”.¹

Consideration was defined in *Currie v. Misa*² as—

“Some right, interest, profit, or benefit accruing to the one party, or some forbearance, detriment, loss or responsibility, given; suffered, or undertaken by the other.”

The *test* of consideration would therefore be whether the promisor gets any benefit or the promisee sustains any burden in respect of the promise.

¹ S 2 (d)

² (1875) L.R. 10 Ex. P. 162

Need for Consideration

In *English Law* all simple agreements must be supported by consideration, *i.e.* both parties give and receive something, but a contract made in proper form *i.e.* by deed or under seal is valid even though there is no consideration. That is not the law in *India* where *every agreement must be supported by consideration*.

As gratuitous or voluntary promises are often made rashly without due thought, *only promises made for consideration are binding at law*. This is based on the maxim, "*Ex nudo pacto non oritur actio*" *i.e.* out of a naked pact no cause of action can arise.

ILLUSTRATIONS

(a) In *Abdul Azez v. Mazum Ali*³ the suit was to enforce a promise to subscribe Rs 500 for the rebuilding of a mosque. The court held that the promise was not enforceable for there was no consideration in the sense of benefit.

(b) In *Kedarnath v. Gorie Mohomed*⁴ the defendant had agreed to subscribe Rs 100 towards the construction of a Town Hall at Howrah. The secretary had called for plans, entrusted the work to contractors and had undertaken liability to pay them. It was held that, though the promise was to subscribe to a charitable institution and there was no benefit to the promisor still it was supported by consideration in that the secretary suffered a detriment in having undertaken a liability to the contractor on the faith of the promise made by the defendant. Thus we see that a promise though gratuitous, would be enforceable if, on the faith of the promise, the promisee suffers a detriment or undertakes a liability.

Analysis of Definition

The words, "at the desire of the promisor" imply that consideration must not be voluntary but must arise "at the desire of the promisor".

ILLUSTRATIONS

(a) *D* constructed a market at the desire of the Collector. The stall keepers in the market promised to give *D* a commission on the articles sold by them in the market through their agency. When *D* sued the stall keepers for the commission it was held that the agreement was void for want of consideration because *D* (the promisee) had constructed the market not at the desire of the stall keepers (the promisors) but at the desire of the Collector.⁵ This and the following case illustrate the rule which arises out of the definition that the act constituting consideration should have been done at the desire or request of the promisor. If it is done at the desire of a third party, it will not be consideration.

³ (1914) 36 All. 268; 12 ALJ

⁴ (1886) 14 Cal. 64

⁵ *Durga Prasad v. Baldeo* (1880) 3 All. 221

(b) During a strike by the workers in a coal mine, the police authorities thought it enough to provide a mobile force for the protection of the mine. The colliery manager wanted a stationary guard. It was ultimately agreed to provide the stationary guard at a payment of £ 2,200. Subsequently the company refused to pay, pleading absence of consideration. Held that the contract was supported by consideration and the company was liable to pay. The police authorities provided the stationary guard at the express desire of the manager of the company for the protection of the mine.⁶

(c) In *Gopal Coy , Ltd. , v. Hazari Lal Co.*,⁷ it was held that even though the act may result in a benefit to a third party the consideration would be quite valid.

Consideration may move from the Promisee or any Other Person

The next words to be noted are "*the promisee or any other person*". This means that, unlike English law where the consideration must move from the promisee, in Indian Law the consideration may move either from the promisee or even from "*any other person*". This means that even a *stranger to the consideration may enforce an agreement provided, of course, he is a party to the agreement*.

For example, *A* granted an estate to *C* and directed her to make an annual payment to *A*'s brother; *C*, by an agreement of the same date made with *A*'s brother, promised *A*'s brother to give him such annual payment. It was held that there was sufficient consideration for the promise of *C* to *A*'s brother.⁸ In this case it will be observed that although *A*'s brother was a stranger to the consideration from *C* he was not a stranger to the agreement *i.e.*, the agreement made between himself (*A*'s brother) and *C*, *A*'s brother could not have sued on the agreement between *A* and *C* as he was not a party to it. Thus the distinction between one who is a stranger to the consideration and one who is a stranger to the agreement should be carefully noted. From this it is clear that *under the English Law a stranger to consideration cannot sue in Indian Law a stranger to consideration can sue on the contract provided he is a party to the contract*.

A "*stranger to the contract*" cannot sue either in English or Indian law. This means that unless there is *privity of contract* no legal bond can be created under contract. In other words, no rights or obligations can arise under a contract except in relation to those who were parties to it.

⁶ *Glass Brook Bros. v. Glamorgan County Council*, (1925) A.C, 270

⁷ AIR (1963) M.P. 37

⁸ *Chinnaya v. Ramayya* (1881), 4 Mad. 137

The following are *exceptions* to the rule that a stranger to a contract cannot sue under it.

(1) **When a trust is created:** Where under a contract one of the parties constitutes himself a trustee for a third party, the later, i.e. the beneficiary, may sue to enforce the trust in his favour and there will be no objection on the ground of his being a stranger to the contract.⁹

(2) Where the promisor between whom and the stranger there is no privity of contract, has by his conduct, whether by acknowledgment or by part payment or by estoppel constituted himself the agent of the third person.

ILLUSTRATION

A who had received money from B for payment to C admitted to C that he had received the money from B. Held A is deemed to have constituted himself the agent of C and therefore C can recover the amount from A.¹⁰

(3) **Where a provision is made in a marriage arrangement:** The Common Law doctrine of privity of contract is not applied to consideration in India where parents decide to contract marriage on behalf of minors as otherwise it would cause injustice.

ILLUSTRATION

In *Khwaja Mohamed v. Hussaini Begum*¹¹ a Mohammedan lady sued her father-in-law to recover Rs 15,000 being arrears of allowance at Rs 500 per month for Kurch-i-Pandan (betel box expense or pin Money) under a promise made to her father by her father-in-law. The Privy Council held the promise to be enforceable at her instance though the lady was not a party to the contract.

(4) **Where a charge has been created on specific immovable property in favour of a person:** Such charge is enforceable at the instance of the person beneficially entitled even though he may be a stranger to the contract.¹²

(5) **Where a provision is made in a partition or family arrangement for maintenance or marriage expenses of female members:** In the case of family arrangements providing for the maintenance or marriage expenses of female members, though not parties to the agreement, the female members can sue on the footing of the arrangement as beneficence.

⁹ *Alic v. Accident Insurance Co* (1933) P.C. 11; 64 M.I.J. 133

¹⁰ *Ramaswami v. Krishna* (1935), Madras 904

¹¹ (1910) 32 All 410; 371 A 152

¹² *Suryanarayana Rao v. Basjri Reddy*, (1932) 55 Mad. 436

ILLUSTRATIONS

(a) In *Shuppu Ammal v. Subramanyan*¹³ two brothers, on a partition of the family properties, agreed to pay Rs 300 in equal shares to their mother for maintenance. It was held that the mother, though a stranger, could enforce the promise.

(b) Similarly¹⁴ a sister was allowed to sue for her marriage expenses under a partition deed, between her brother, to which she was no party.

These cases have been decided on the strength of the *obiter dictum* contained in the Privy Council case, the hardship in applying the common law doctrine in India.

Consideration May Be Past, Present or Future

From the words, “has done or abstained from doing or does or abstains from doing or promises to do or abstain from doing” in the definition it is clear that consideration may be past, present or future.

(i) Consideration is said to be *executed* (i.e. present) when one of the two parties has either by the offer or the acceptance done all that he is bound to do under the contract, leaving an outstanding obligation on the other party only.

(ii) Consideration is said to be *executory* (i.e. future) when the consideration consists in a promise to be performed in the future.

(iii) *Past consideration* is some act or forbearance which has taken place in the past and by which a person has benefited without incurring any legal obligation i.e. one which is wholly executed before the promise.

ILLUSTRATIONS

(a) A enters a bookstall and buys a book which he takes away with him, promising to pay the price on the following day. Here A's consideration is executory and the bookseller's consideration is executed.

(b) A's son has been rescued from drowning by B. Subsequently, A promises to pay for the service rendered by B in the past and for which service A was not legally bound to pay. B's consideration in this case is past consideration.

In *English Law* an executed or executory consideration would be sufficient to support a simple contract, but a past consideration would not, whereas, according to *Indian Law*, as we have already learnt, a past act is also sufficient to support a simple agreement. In *English Law*, however, there are two exceptions to the general

¹³ (1910) 33 Mad. 238. 4 I.C. 1083; 19 M.L.J. 739

¹⁴ *Sundararaja v. Lakshmi Ammal* (1915) 38 Mad. 788; 24 I.C. 943

rule as to past consideration, viz: (1) When the past consideration is given at the request of the person who makes the promise, or (2) When a party, say under some Act such as the Statute of Limitation, is not bound to pay a debt because six years have expired, gives a promise to pay it in writing, the agreement is binding though based on a past consideration.

Consideration Need Not Be Adequate

As long as the consideration is of some value it is *not necessary that it should be adequate*. That is a matter for the parties themselves to settle when entering into a contract. The Court will never interfere on the ground of the inadequacy of consideration *unless fraud is proved, or the contract is in restraint of trade*.

According to Anson, "consideration need not be adequate to the promise, but it must be of some value in the eyes of law. The courts will not make bargains for the parties to a suit nor inquire whether it was an equivalent to the promise which he gave in return. The consideration may be of benefit to the promisor or to a third party, or may be of no apparent benefit to anybody, but merely a detriment to the promisee, in any case. The adequacy of the consideration is for the parties to consider at the time of making the agreement, not for the court when it is sought to be enforced".

ILLUSTRATIONS

(a) The leaving off of a vicious habit such as chewing tobacco, would be a sufficient consideration to support a promise.

(b) The parting with property by a person for however short a time has been held to be a detriment and sufficient consideration to support a promise.

(c) Even the surrender of a document which was found to be unenforceable at law, has been held to be a sufficient consideration for a promise to pay £10,000.¹⁵

Consideration must be of some value

✓ Although consideration need not be adequate to the promise it *must be real and not illusory*.

ILLUSTRATIONS

1. Consideration which is physically or legally impossible or which is uncertain is not real.

2. A compromise of a disputed claim made *bona fide* is a valuable consideration for a promise, although the claim was an

¹⁵ *Haigh v. Brooks*, 10 A & E 309

unfounded one, as long as the plaintiff honestly believed he had a good claim.¹⁶

Consideration must not be something the promisor is already under an obligation to do

It must be remembered that if a man does that which he is legally bound to do that is no consideration. Thus according to *English Law* where a man pays a *smaller sum in satisfaction of a larger*, such payment will not be a *good discharge* of the debt because he is doing nothing more than he is legally bound to do, e.g., if *A* owes £ 50 to *B* and pays £ 45 in cash, taking a receipt in full, there is nothing to prevent *B* from suing for the balance in spite of the receipt. There must be something new to support this promise of *B* not to sue for the balance of £ 5. In one case, however, where a cheque was given by *A* to *B*, say for £ 45, and *B* gave a receipt for the full amount of £ 50, it was held that the cheque being a negotiable instrument, a new right of action on that instrument was given, which may be taken as a consideration for the promise of *B* to *A* for the balance of £ 5.

In *India*, however, Section 63 of the Contract Act gives a clear power to dispense with or remit wholly or in part a debt due from the debtor. The exact language of the section runs as follows:—“Every promisee *may dispense with or remit*, wholly or in part, the performance of the promise made to him, or *may extend the time* for such performance, or *may accept instead* of it any satisfaction which he thinks fit”. The illustration (b) to this section gives a clear example, viz., “*A* owes *B* Rs 5,000. *A* pays to *B*, and *B* accepts, in satisfaction of the whole debt. Rs 2,000 paid at the time and place at which Rs 5,000 were payable. The whole debt is discharged. In *English Law* this would be known as a “waiver” which is a mere agreement to forego contractual rights, and cannot be valid where the contract is executed, unless made under seal or for consideration.

Consideration must be lawful

The consideration must be lawful, must not be of an immoral nature or contrary to public policy because the courts do not allow an action on such contracts on the maxim, *ex turpi causa non oritur actio*.

According to Section 23, the consideration or object of an agreement is *unlawful* if:

¹⁶ *Callshier v. Bischoffsheim* (1870) L.R.S.Q.B. 449

- (i) It is forbidden by law, or
- (ii) It is of such a nature that, if permitted, it would defeat the provisions of any law, or
- (iii) It is fraudulent, or
- (iv) It involves or implies injury to the person or property of another, or
- (v) The Court regards it as immoral, or opposed to public policy.

When the consideration or object is unlawful the agreement is void. It should be noted that the terms "consideration" and "object" are not synonymous. While 'consideration' means the benefit or burden received or given under the agreement, 'object' refers to the purpose of the agreement. Details on agreements the object or consideration of which is wholly or partly unlawful are given in the next chapter.

A Contract Without Consideration is Void

In Indian Law the general rule is that an agreement made without consideration is void but there are *three exceptions* to this rule:

(1) It is in *writing* and *registered* and is made on account of *natural love and affection* between parties standing in a *near relation* to each other, or

(2) It is a promise to compensate, wholly or in part, a person who has already *voluntarily* done something for the promisor, or something which the promisor was *legally compellable* to do, or

(3) It is a *promise* in writing and signed, to pay a debt barred by limitation (S. 25).

First Exception

In order to come within the first *exception* each one of the italicised ingredients must be present. For example, there is near relationship between husband and wife and between brothers but nearness of relationship does not necessarily imply natural love and affection. For example, a Hindu husband executed a registered instrument in favour of his wife for separate residence and maintenance, no consideration moving from his wife. It was held that the agreement was void and did not come within this exception as the recitals in the agreement which referred to quarrels between the parties showed that it was not made on account of natural love and affection.¹⁷

¹⁷ *Raj Lakhi Debi v. Bhutnath*, 4 C.W.N. 488.

Second Exception

In the second *exception* the word "*voluntarily*" should be noted. According to this exception if a promise is given to compensate another for services voluntarily rendered or something which the promisor was legally compellable to do *the promise is binding although there is no consideration*. If the services were rendered at the request of the promisor, they are covered by the definition of consideration in Section 2 (d), "when at the desire of the promisor the promisee or any other person has done or abstained from doing...."

Thus in Indian law past consideration is sufficient to support a subsequent promise whether the past consideration was voluntary (exception 2 to S. 25) or whether it moved at the request of the promisor [S. 2(d)].

In this connection it should be noted that the act voluntarily done must have been done *for the promisor* or in reference to something which *the promisor* was legally compellable to do e.g. where A voluntarily finds B's purse a promise given by a third party, say C, to reward A would not be covered by this exception. Besides, as the act thus voluntarily done must have been done "for the promisor" it follows that the promisor should have been in existence at the time when the act was first voluntarily done e.g. a promise by a company after its incorporation to pay a promoter does not fall within this exception as the promoter could not have been deemed to have done anything for a company which was not in existence at the date of the act.

Thus the *essential* of this exception are:

- (a) The services must be rendered *voluntarily*.
- (b) The services must have been rendered *for the promisor*.
- (c) The *promisor* must have been *in existence* at the time when the services were rendered or the voluntary act was done.
- (d) The *intention* of the promisor must have been *to compensate the promisee*.

Third Exception

The third *exception* is a *promise to pay a time-barred debt*. The word *promise* should be noted and this should be *distinguished from a mere acknowledgement* under Section 19 of the Limitation Act. Both an acknowledgement and a promise must be in *writing* and *signed* and both create a fresh starting point of limitation, but

whereas an acknowledgement under the Limitation Act must be made before the expiry of the period of limitation, a promise under this exception may be made after the expiry of the period of limitation.

It has been held that in order to come within this exception there must be an *express* promise to pay though the word express is not used in Section 25 (3).¹⁸

Thus an agreement made without consideration *i.e. a one sided undertaking is void* unless it is covered by one of the abovementioned exceptions. For example, some companies have elaborate printed terms of agreements with several clauses in their own favour such as giving the company the right to cancel the agreement. Sir Dinshah Mulla has held in a Bombay High Court decision¹⁹ that such a power can be exercised for a valid reason and not arbitrarily as otherwise the agreement would be void for want of mutuality, the right to cancel being one-sided only.

SUMMARY

Definition of Consideration: The Indian Contract Act defines consideration as follows: "When at the desire of the promisor the promisee or any other person has done or abstained from doing or promises to do or abstain from doing something, such act or abstinence or promise is called a consideration for the promise" Section 2 (d).

It is defined in the English case, *Currie v. Misa* as: "some right interest, profit or benefit accruing to the one party or some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other".

Thus consideration is something given for something received.

Need for Consideration : In English law all simple agreements (*i.e.* all except specialty contracts) are required to be supported by consideration. In India every agreement must be supported by consideration except in 5 cases mentioned later.

Analysis of Definition : From an analysis of the definition we gather the following points:

1. Consideration must move at the desire of the promisor.
2. Unlike in English law, consideration may move from the promisee or from any other person. This means that a stranger to the consideration can claim on the contract provided he has been made a party to the contract.

¹⁸ *Jeevraj v Lalchand*, A.I.R. (1969) Raj. 19

¹⁹ *Chhotalal v. Chamsey* 24 Bom. L.R. 877

3. Consideration may be past, present (executed), or future (executory).
4. Consideration may be positive or negative. *i.e.*, an act or abstinence.

Rules as to Consideration in Indian Law

1. Consideration is necessary to support any agreement.
2. Consideration must move at the desire of the promisor.
3. Consideration may move from the promisee or any other person.
4. Consideration may be past, executed or executory.
5. Consideration need not be adequate to the promise.
6. Consideration must be of some value, it must be real and not illusory.
7. Consideration must not be something the promisor is already under an obligation to do.
8. Consideration must be lawful and should not be immoral or opposed to public policy.
9. Every agreement must be supported by consideration.

General Rule: Every agreement must be supported by consideration or An agreement without consideration is void.

Exceptions to General Rule: The following are valid even though there is no consideration:—

(1) An agreement in writing and registered under the law for the registration of documents and made on account of natural love and affection between parties standing in a near relation to each other.

(2) A promise to compensate wholly or in part, for a voluntary past act or something which the promisor was legally bound to do.

(3) A promise in writing and signed to pay a time-barred debt.

Difference Between English and Indian Law

English Law	Indian Law
1. Consideration must move from the promisee only.	1. Consideration may move from the promisee or any other person <i>i.e.</i> a stranger to consideration may sue on the contract.
2. A voluntary past act is no consideration.	2. A past act whether voluntary or not will support a subsequent promise.
3. Every simple agreement must be supported by consideration. Formal or specialty contracts do not need consideration.	3. All agreements must be supported by consideration.
4. Consideration is necessary not only for the formation of a contract but also for its discharge or waiver of the promise under it in a bilateral agreement (Accord and satisfaction).	4. Consideration is necessary for the <i>formation</i> of the contract not for its discharge or waiver.

TYPICAL QUESTIONS

1. 'A stranger to a contract cannot sue.' However there are certain exceptions to this rule both under the Indian and English law. What are they?

2. Discuss the rule that a third party to a contract cannot sue upon it.

3. Critically examine the following:—

(a) "All contracts without consideration are void".

(b) "All void contracts are not necessarily illegal".

4. Indicate the cases where agreements made without consideration are valid. *X* promises in writing to subscribe Rs 10,000 to the Gandhi Memorial Fund. Subsequently *X*, did not pay the subscription. Can the contract be enforced against *X*? Explain giving reasons.

5. In what circumstances, if any, may a third party sue on a contract entered into between two parties?

A, a solicitor, agrees with his partner *B* that, on the death of either partner the survivor will pay an annuity of Rs 1 000/- to the widow of the deceased partner *A* dies and *B* refuses to pay anything to *C* who is *A*'s widow. Advise *C*.

6. Explain 'consideration' as an element in a valid contract. State the exceptions to the rule that an agreement without consideration is void.

7. Define past and executory consideration. Is adequacy of consideration material for the purpose of determining whether an agreement is a valid contract?

8. Should consideration always move from the promisee?

9. *A* fell into a river. *B* rescued him, and in gratitude *A* made an oral promise to pay *B* Rs 1,000. *A* now refuses to pay the money. Has *B* any remedy against *A*?

10. (a) *A* writes to *B* "At the risk of your own life you saved me from a serious motor accident. I promise to pay you Rs 500.". *A* does not pay the amount. Advise *B* as to his legal rights.

(b) *A* contracted with *B* corporation to build a number of houses. In calculating the cost of the houses *A* by mistake deducted a particular sum twice over and submitted his estimates accordingly. The corporation agreed to the figures which were naturally lower than the actual cost. Discuss whether the agreement as it stood when the corporation affixed its seal is binding.

Chapter 8

CONTRACTS

Lawful Object

AGREEMENTS must be for a Lawful Object and not Contrary to Positive Law, Morality or Public Policy.

The Indian Contract Act lays down in Section 23 that where the consideration or object of an agreement is

- (1) forbidden by law, or
 - (2) is of such a nature that, if permitted, it would defeat the provisions of any law, or
 - (3) is fraudulent, or
 - (4) involves or implies injury to the person or property of another, or
 - (5) the Court regards as immoral or opposed to public policy.
- Such agreement is void.

The word "object" is used in this section as distinguished from "consideration" and means "purpose" or design.¹

We shall now deal with each of the above in detail.

¹ *Jaffer Meher Ali v. Budge Budge Jute Mills Co.* (1906) 33 Cal. 702, 710

1. Forbidden by Law

According to Section 23, if the object or consideration of an agreement is forbidden by law, the agreement is void. Thus where the agreement is to do something which is punishable by the criminal law or is prohibited by any other statute or regulations made by a competent authority as in the case of delegated legislation, the object of the agreement is unlawful.

ILLUSTRATION

A, B, and C enter into an agreement for the division among them of goods acquired, or to be acquired by them by robbery. The agreement is void, as the object is unlawful.

2. Defeat the Provisions of any Law

If the object or consideration of an agreement is of such a nature that, if permitted, it would defeat the provisions of any law, the agreement is for an unlawful object or consideration and therefore void under Section 23.

These are cases where though the agreement may not be expressly forbidden by law its effect may be such that it would adversely affect the provisions of law.

ILLUSTRATION

An agreement between a landlord and tenant that the tenant would not avail himself of the protection of the Rent Act is void because though the Rent Act does not forbid such agreements it would defeat the provisions of the statute.²

3. Is Fraudulent

Agreements for the purpose of committing a fraud are void as the object is unlawful.

ILLUSTRATION

An agreement between persons to buy shares in a company with the object of inducing the public to believe that there is a market for such shares is fraudulent and therefore void.

4. Injury to Person or Property

Agreements to commit assault, murder or other physical injury to any person or, to set fire or otherwise damage someone's property would be void under this head.

² *Saleh v. Manekji*, 50 Cal. 491

5. If the Court Regards it as Immoral

Agreements where the object or consideration is immoral are void.

ILLUSTRATION

Where an agreement is made to let a house for an immoral purpose, or to print an indecent picture or book, it is void and the landlord in the former and the printer in the latter case cannot sue on it.

6. Opposed to Public Policy

Public policy is difficult to define precisely. An agreement is regarded as opposed to public policy if it is of such a nature that it tends to prejudice the general welfare of the State or the interest of the public, such as agreements which prejudice the State's interests in time of war (trading with enemies) or stifling prosecutions. In private life agreements which attempt to impose inconvenient and unreasonable restrictions on the rights of individuals to freely exercise any lawful trade or calling are opposed to public policy with certain reservations. These are called "agreements in restraint of trade".

The Courts cannot invent a new head of public policy but the doctrine of public policy can be applied to new cases within the heads already recognised.

The following are some of the recognised heads of public policy.

(a) *Agreements in Restraint of Trade*

ENGLISH LAW

If an agreement is entered into, which places a certain restraint or check on the liberty of a person to carry on a lawful business, trade or profession, such an agreement may be good or void according as to whether the restraint imposed is reasonable or not. Whether the restraint is reasonable or otherwise, is a question of fact which would have to be decided according to the circumstances of each individual case. Persons buying up a business and paying money for goodwill generally require the seller to give them an agreement to the effect that he will not trade within certain limits. In spite of this restraint such an agreement may be good if the restriction is reasonable. *Reasonable* means such as would afford the party a fair protection as far as his interests are concerned. No

limit as to time or space is necessary in order to bring a contract within the definition of reasonableness; but *in India* the restraint must be "within specified local limits" which seem reasonable to the Court looking to the nature of the business. Thus a wide restraint which is unlimited as to space would certainly be considered unreasonable in India. A contract, however, to sell all salt produced to *B* and not to anyone else at a certain price is not a restraint which is objectionable. In the case of agreements of service if an employee agrees that he will not compete with his employer during the term of service, it is not a restraint of trade.

To *Summarise*, contracts in restraint of trade are not contrary to public policy and are valid if

- (1) they are not unreasonable looking from the standpoint of the person on whom the restraint is levied, or if
- (2) they are reasonably necessary to protect the interest of the party in whose favour the restraint is imposed, or if
- (3) they are generally speaking not injurious to the public.

Under the old Common Law dating from the age of Queen Elizabeth, all restraints of trade were considered to be undesirable and bad, but in course of time it was realized that in the business world particularly, certain restraints were not contrary to public policy but were desirable in the interest of trade itself: for example, when a person wishes to sell the goodwill of his business, unless the seller can be restrained from carrying on a competing business in the same line, the amount paid by way of goodwill will be lost and the seller under such a circumstance will not be able to secure any goodwill value at all. Thus the rules against restraints were gradually relaxed. If on reading a contract it appears that the restraint is unreasonable and would be against the interest of either party, that will constitute an objectionable restraint. Of course the court will decide this question by taking all the circumstances, such as the nature of the business or trade or occupation, the area covered by the restraint, and the period of time for which the restraint has to operate, into consideration.

INDIAN LAW

The *Indian Law* as to restraint of trade is found in Section 27 of the Indian Contract Act and in Sections 11, 36, 54 and 55 of the Indian Partnership Act. In India, the general rule is that an agreement under which a restraint is imposed on the liberty of a person

to carry on a lawful trade, profession or business is void and ineffective as far as such restraint is concerned the exact wording of the section being, "Every agreement by which anyone is restrained from exercising a lawful profession, trade or business of any kind, is *to that extent* void". This means that if, the agreement can be divided into separate parts it will be valid as to the parts which are not in restraint of trade but if it is indivisible the whole agreement will be void. However the *following restraints are valid* even in Indian law provided that having regard to the nature of the business, such limits appear reasonable to the Court:—

(1) A restraint, placed on the *seller of the goodwill* of a business under which he agrees not to carry on a similar business within specified local limits as long as the buyer or someone succeeding to the goodwill from such buyer, carries on a similar business within the agreed local limits.³

(2) An agreement by a *partner* with his other partners that while he is a partner in the firm he will not carry on any business other than that of the firm.⁴

(3) An agreement by a *partner* with his other partners that on retiring from the partnership he will not carry on any business similar to that of the firm within a specified period or within specified local limits.⁵

(4) An agreement among the partners, upon or in anticipation of *dissolution* of the firm, that some or all of them will not carry on a business similar to that of the firm within a specified period or within specified local limits.⁶

(5) An agreement between any partner and the buyer of the firm's goodwill that such partner will not carry on any business similar to that of the firm within a specified period or within specified local limits.⁷

The *Indian law* is thus *very strict* on the point of restraint of trade and therefore unless the restraint comes within one of the above exceptions, it will be void, and thus many agreements which would be valid under the Common law of England are void under the above section.

³ Section 27, *Indian Contract Act*

⁴ Section 11 (2), *Indian Partnership Act*

⁵ Section 36 (2), *Indian Partnership Act*

⁶ Section 54, *Indian Partnership Act*

⁷ Section 55 (3), *Indian Partnership Act*

The following agreements are *not* in restraint of trade. For example an agreement by a doctor's assistant that the latter would not practise on his own account *during* the agreed term of his service would not be in restraint of trade⁸ but if he agreed not to practise on his own after the duration of his term of service it would be in restraint of trade and therefore void. A stipulation, by which a party to an agreement undertakes not to sell to others for a specified time any goods of the same description as they are selling to the other party, is not in restraint of trade. So also an agreement to sell all the salt manufactured by *A* during a specified period to *B* at a certain price is not in restraint of trade. When manufacturers entering into trade combinations agree not to sell their goods below a certain price that is not a restraint of trade as it does not prevent either party from exercising his business of manufacturing or selling goods. It merely lays down terms on which such business may be exercised.

(b) *Marriage Brokerage etc.*

On the same ground of public policy a marriage brokerage contract, or an agreement *to pay money to the parent* or guardian of a minor in consideration of such parent or guardian consenting to the said marriage, is void and if the minor is not given in marriage damages cannot be recovered from the parent or guardian.⁹ Similarly if the marriage does take place, the parent or guardian cannot recover the promised reward.¹⁰

(c) *Interest Against Duty*

Agreements for the sale of *public offices*, agreements with public servants to use their *influence* with other public servants in order to obtain some *benefit*, are agreements tending to create interest against duty and therefore void.

(d) *Agreements in Restraint of Legal Proceedings*

Certain offences such as assault, etc. are known as *compoundable offences*, *i.e.*, in or outside a court the parties can come to a settlement. There are other offences of a very serious nature which the law has declared to be *non-compoundable* and in that case any compromise made with a view not to prosecute would be bad and a criminal offence in itself. In *mercantile transactions*, frequently, a

⁸ *Charlesworth v. Macdonald* 1899, 23 Bom. 103

⁹ *Dholidas v. Fulchand* 32 Bom. 658.

¹⁰ *Baldeo Das v. Mohamaya*. 15 Cal. W.N. 477.

person commits a breach of trust or similar offence. In such a case the employer with whom the breach of trust has been committed has a right to recover money so misappropriated through a civil action. This *civil case* he may compromise if he so desires but he should not give an undertaking that this compromise would mean that the party who had committed this serious offence will not be prosecuted.

Agreements in restraint of legal proceedings are *void*. Section 28 says that if a party is restricted *absolutely* from enforcing his rights under, or in respect of, any contract by the usual legal proceedings in the ordinary tribunals, such an agreement is void to that extent. The section, however, *exempts* from its operation contracts to refer to arbitration. This is because a simple contract to refer to arbitration does not oust the jurisdiction of the court; the arbitrator's award is liable to be set aside, modified or otherwise dealt with by the court. If an agreement stated that all the disputes between the parties shall be referred to arbitration and that the decision of the arbitrators shall be final, the first part of the agreement would hold good and can be enforced, whereas the second part would be void.

(e) *Champerty and Maintenance*

This is promotion of litigation in which the person promoting has no interest, with or without a bargain with the party assisted by labour or money, to divide the proceeds or gains of such litigation with the person so promoting or assisting. When there is a bargain to receive a share in the property if recovered, it is *champerty* but when there is no such bargain it is *maintenance*. The *English Law* forbids such practices and makes the person so wrongfully assisting or maintaining the litigation liable to an action for damages at the suit of the person injured. The rules of English Law have not been adopted in India but it has been held by the Privy Council in *Bhagwat Dayal Singh v. Devi Sahu*¹¹ that an agreement champertous in English Law was *not necessarily void in India*; it must be proved to be against public policy to render it void. Thus if a contract falling under this heading is proved to be "against good policy and justice", or "tending to promote unnecessary litigation" or "in a legal sense is immoral" it would be void in India.¹² This is because of the peculiar position of Indian liti-

¹¹ (1908), 35 Cal. 420

¹² *Fischer v. Kamla Naicker* (1890), 8 M.I.A. 170

gants many of whom are too poor to afford an expensive litigation. "The uncertainties of litigation are proverbial; and if the financier must needs risk losing his money he may well be allowed some chance of exceptional advantage."¹³

(f) *Restraint of Marriage*

"Agreements, in restraint of marriage of any person other than a minor are *void*" (S. 26). Thus an agreement by a person not to marry at all is void as being *against public policy*. In India it would also be void even though the agreement refers only to one particular person, or a particular class of persons, whom the party agreeing undertakes not to marry. In *England* restraint against marrying a particular person is, however, valid.

We have already dealt with agreements in Restraint of Trade and of Judicial Proceedings.

Part of Consideration or Object Unlawful

"If any part of *a single consideration* for one or more objects, or any one or any part of several considerations *for a single object*, is unlawful, the agreement is void" (S. 24).

For example, *A* promises to superintend on behalf of *B*, a legal manufacture of indigo, and an illegal traffic in other articles, *B* promises to pay *A* a salary of Rs 10,000 a year. The agreement is void, the object of *A*'s promise and the consideration for *B*'s promise being in part unlawful (ill: to S. 24).

We learnt in Section 23 that an agreement is void if its object or consideration is unlawful. Section 224 follows naturally from this as when a consideration or object is indivisible if part of it is unlawful the whole agreement is void. The general rule is that where you cannot sever the illegal from the legal part of a covenant, the contract is altogether void; but where you can sever them whether the illegality be created by statute or by the common law, you may reject the bad part and retain the good.¹⁴

SUMMARY

Agreements which are for an unlawful object or consideration are void. These are agreements where the object or consideration.

1. is forbidden by law, or

¹³ *Ram Sarup Court of Wards* (1940) 67 I.A. 50

¹⁴ *Pickering v. Ilfracombe Ry Co.* (1868) L.R. 3C.P. 235 at P.250

2. is such that it would defeat the provisions of the law, or
3. is fraudulent, or
4. involves or implies injury to the person or property of another, or
5. is immoral, or
6. is opposed to public policy

Heads of Public Policy

1. Restraint of trade
2. Marriage Brokerage
3. Interest against duty
4. Restraint of legal proceedings
5. Champerty and Maintenance
6. Restraint of Marriage

TYPICAL QUESTIONS

1. Discuss the Indian Law with regard to agreements in restraint of trade.
2. What agreements are said to be opposed to public policy? Are they enforceable?
3. What are Unlawful Agreements? Explain their nature and character.
4. State whether the following agreements are void or valid. Give your reasons in each case:-
 - (1) *A* promises to pay a certain sum of money to *B*, who is an intended witness in a suit against *A*, in consideration of *B*'s absenting himself at the trial.
 - (2) In a suit by *A* against *B* for the recovery of Rs 2,000, *A* is in need of money. *C* agrees to provide funds to *A* in consideration of sharing half the money recovered from *B*.
 - (3) *A* promises *B*, in consideration of Rs 1,000 never to marry throughout his life.
 - (4) *A* promises *B*, in consideration of Rs 1,000 never to marry a particular individual.
5. Discuss the law relating to contracts in restraint of trade. *A*, a doctor practising in Bombay, engages *B* as his assistant for a period of three years, on condition that after the expiry of three years *B* is not to practise in Bombay on his own for a period of the five years. After the first three years had expired, *B* in breach of his agreement starts practising in Bombay. *A* sues *B* to restrain him from practising. Will *A* succeed?

6. A, a machinegun manufacturer, sold his business to a company, in consideration of some amount of goodwill, and covenanted that he would not carry on a similar business for a certain time anywhere in the world. Is such a covenant binding upon him? Is there any difference on the point under the English and Indian Laws?

7. "Certain objects of contract are forbidden or discouraged by law; and though all the other requirements for the formation of a contract to be complied with, yet if these objects are in contemplation of the parties when they enter into the agreement, the law will not enforce it". Discuss the above statement giving illustrations.

Chapter 9

CONTRACTS

Agreements not Declared Void

Agreements not Declared Void

As we have learnt in an earlier chapter *one of the Essentials of a valid agreement*, is that it should not have been declared void by any law in force in India. The Indian Contract Act has declared certain agreements *void* therefore such *agreements are not contracts* as they cannot be enforced in court.

Agreements Declared Void by Contract Act

The following agreements are void according to the provisions of various sections of the Indian Contract Act—

- (1) Agreements by persons who have no legal capacity to be bound by a contract (S. 11)
- (2) Agreements entered into through a mutual mistake of fact between the parties (S. 20)
- (3) Agreements, the object or consideration of which is unlawful (S. 23)
- (4) Agreements, part of the consideration or object of which is unlawful (S. 24)

- (5) Agreements made without consideration (S. 25)
- (6) Agreements, in restraint of marriage of any person other than a minor (S. 26)
- (7) Agreements in restraint of trade, with certain exceptions (S. 27)
- (8) Agreements in restraint of legal proceedings, except contracts to refer to arbitration (S. 28)
- (9) Uncertain agreements (S. 29)
- (10) Wagering agreements (S. 30)
- (11) Impossible agreements (S. 56)

We have already dealt with all the above, except the last two, in earlier chapters.

Wagering Agreements

A wager is *defined* by Anson as “a promise to give money or money’s worth upon the determination or ascertainment of an uncertain event”. Section 30 lays down that “agreements by way of wager are void and no suit shall be brought for recovering anything alleged to be won on any wager, or to recover anything entrusted to any person to abide the result of any wager”.

The section makes an *exception* in favour of certain prizes for horse-racing by providing further that, “This section shall not be deemed to render unlawful a subscription or contribution, or agreement to subscribe or contribute, made or entered into for or toward any plate, prize or sum of money, of the value or amount of five hundred rupees or upwards to be awarded to the winner or winners of any horse-race.”

With regard to wagering agreements it may be noted that two parties may enter into a formal contract for sale and purchase of goods at a given price and for their delivery at a given time. If, however, the circumstances are such as warrant the legal inference that both the contracting parties never intended the actual transfer of goods, but that their dominant idea was to give or receive the difference between the market price and the contract price at the time of delivery, such a contract is not based on a genuine mercantile transaction, but on a mere wager or bet on the rise or fall of the market. In one case a series of contracts were entered into in Dhollera for the sale and purchase of Broach Cotton. It was proved that Broach Cotton never entered Dhollera and that none of the contracts were ever completed by delivery but by payment of differences between the contract price and the market price in Bombay on the *vaida* day. Thus although the contracts were made on printed forms

which provided for delivery of cotton and forbade gambling in differences it was held on the above that the contracts were by way of wager and therefore void.¹ In short, in the case of wagering contracts *neither party* thinks of or intends to *perform* the contract itself, but the *dominant idea* is to receive or pay *differences* on the happening or failure of an event the final issue of which is uncertain. The agreement will also be a wagering agreement in cases where though the dominant intention of the parties was to pay or receive the market difference, there was stipulation which gave one of the parties an option to demand delivery on the payment of an extra sum.

It will thus be seen that an agreement which to all appearances is a simple mercantile transaction in the form of an agreement to sell may be a pure and simple wager. The Courts of Law will take all the circumstances of the case in view before arriving at a decision on this point. In the words of Davar J., "what the Court has to do is not simply to look at the transactions as they appear on the face of them, but to go beyond them, and ascertain the true nature of the dealings between the parties by probing into surrounding circumstances and minutely examining the position of the parties and the general character of the business carried on by them".² In a later case the Privy Council extended this principle considerably by holding that "the mere fact that a contract for sale and purchase of goods is of a highly speculative character, cannot alone vitiate the transaction as a wagering contract within the meaning of Section 30 of the Indian Contract Act, 1872. To produce that result there must be proof that the contract was entered into upon the terms that performance of the contract should not be demanded, but that differences only should become payable". They went further and stated that "when no such definite agreement or undertaking was proved and it appeared that delivery of the goods might always have been insisted on, the contract was not bad on the ground of of wagering".³

It may be added here that *lotteries* are games of chance where the prize is dependent on the drawing or casting of lots. The Penal Code⁴ makes it an offence to keep any office or place for the purpose of drawing any lottery without the authority of Government.

Agreements Collateral to Wagering Contracts

The Indian Contract Act makes a wagering contract void and not illegal, thus the fact that the transaction is a *wager does not taint*

¹ *Doshi Talakshi v. Shah Ujamshi Velsi*, (1889) 24 Bom. 227

² *Hurmukhrai Amolakchand v. Narotamdas Gordhandas*, 9 Bom. L.R. 125

³ *Sukdevdoss Ramprasad v. Govinddoss Chaturbhujadoss and Co.*, 30 Bom. L.R. 238

⁴ Section 294 A

collateral transactions, therefore, the said collateral transactions can be enforced, *e.g.* (1) A loan to help the payment of a gambling debt; (2) Brokerage on a wagering contract; (3) Deposit on same, etc. Under the Bombay Act III of 1865, which follows the *English Law*, agreements collateral to wagering are void and no money knowingly paid by an agent at the request of his principal on account of wagering transactions, nor the commission payable by way of fees, reward, etc., would be recoverable by action in the Presidency of Bombay whether the plaintiff be or not be a party to such a transaction. This act applies only to Bombay and therefore elsewhere in India transactions collateral to a wagering agreement are good.

Teji Mandi Transactions

These transactions are divided into three classes, *viz.*: (1) Teji pure and simple, (2) Mandi pure and simple, and (3) Teji Mandi or both the transactions combined.

We shall now proceed to explain each class separately with the help of an illustration.

In the case of *Teji* pure and simple, (known as bull transaction on the London Stock Exchange) what the dealer *A* does is to secure an option to buy a certain quantity of goods, say 100 bales of cotton, at Rs 500 per bale. In consideration of this option being given to him by merchant *B* who deals in Teji, he pays him a premium of say Rs 10 on each bale. The *option* here is to *purchase* and take delivery of these bales at some future date, as fixed by both these parties at the time of the contract, if it suits *A*, or failing that *A* is free to abandon the option. The option premium paid is of course non-returnable in either case. Supposing that on the delivery date the market were to rise to say Rs 550 per bale *A* would exercise his option to purchase at Rs 500 and make a profit of Rs 50 per bale, less his option premium of Rs 10 per bale, *i.e.* a net profit of Rs 40 per bale. If, on the other hand, the market were to fall say to Rs 480 on the delivery date, *A* would abandon his option. It will be thus seen that as under any circumstance the option money paid is not refundable, the transaction would not result in a profit unless the market rises above the margin of Rs 10 per bale which is the option premium in this illustration.

In these transactions, *B* the seller of the option is known as *khannar*, *i.e.* 'the Eater' of the option and *A* the buyer is called *lagadnar*, *i.e.* the applier of the option.

On the same principle, in the case of *Mandi* (or bear transaction in England), if *A* thinks that the market is going to fall, he secures

an option from *B* to sell a certain number of bales, say at Rs 500 to *B*, to be delivered at some future date fixed by the parties. Here supposing that Rs 10 per bale was the option premium and the market falls to say Rs 460, *A* would purchase these bales at Rs 460 and sell them to *B* at Rs 500 in terms of his option. Here *A* would make a profit of Rs 40 less the option of Rs 10, *i.e.*, net Rs 30 per bale.

In the above transactions the option was single, *i.e.*, *A* purchased in the first case the option only to "buy", whereas in the second case he secured the option only to "sell". There are other transactions where "double options" are dealt in known as *Teji Mandi* transactions.

Here what actually happens is that one party buys what is known as a *double option* and pays a certain premium over the contract price of the commodity. This gives him the right to buy or sell a certain quantity at the price fixed by this agreement on the settling day either of the market concerned or as fixed by the agreement. Thus if *A* buys a *teji mandi* of, say silver at Rs 450 per kg. and for that purpose pays Rs 5 for the *teji* and another Rs 5 for the *mandi* so that if on the settling day the price rises, say it is Rs 465, he may buy the agreed quantity making a net profit of Rs 5 per kg. after reducing Rs 10 paid by way of premium of each transaction. If, on the other hand, the market falls to, say Rs 435, he would sell the quantity at Rs 450 and recover Rs 15 per kg. of which Rs 5 would be his net profit after deducting Rs 10 per kg. for the option premium. The question whether these types of transactions are wagering transactions has been repeatedly discussed in our High Courts. The old view was that such agreements were wagering agreements altogether and therefore void⁵, but in later decisions it was held that *teji mandi* transactions must be regarded as wagering transactions and the onus of proving that they were not such would lie on the party so alleging. In a later case this was further improved upon to the effect that *teji mandi* cannot be held as wagers on account of their apparent nature and characteristics alone but the common intention of parties ought to be proved.⁶ In another case where *teji* alone was bought it was decided that a pure *teji* transaction was on exactly the same footing as *vaida* transactions and unless it could be positively proved that the parties agreed neither to ask for nor to give

⁵ *Ramachandra v. Ganabison* (1910), 12 Bom. L.R. 590.

⁶ *Jessiram Jaggonath v. Tulsidas*, 37 Bom. L.R. 264; *Manilal v. Allibhai*, 24 Bom. L.R. 812.

delivery, the transactions were not wagering transactions.⁷ Teji Mandi contracts are also known as *nazarana* contracts.⁸

Under Section 19 of *The Forward Contracts (Regulation) Act of 1952* all options in goods entered into after August 24, 1953 are *illegal* and those entered into before that date and which remain to be performed become void to that extent. Options in securities are similarly declared *illegal* under the *Securities Contracts (Regulations) Act, 1956*. Thus now all teji, mandi, teji mandi, galli put, call, or put and call transactions are *prohibited*.

Impossible Agreements

Agreements which are impossible of performance are *declared void* under Section 56 of the Indian Contract Act. The impossibility may be

1. Physical
2. Legal
3. Initial or *ab initio*
4. Supervening or subsequent

Physical and Legal Impossibility: It sometimes happens that an agreement is entered into which is impossible of performance. This impossibility may be *physical* or *legal*, it may either exist at the time the contract was entered into, or subsequent events may make performance of the contract impossible.

Section 56 of the Contract Act says that "an agreement to do an act impossible in itself is void". In a subsequent paragraph the section further lays down that even though the act was not impossible, or unlawful at the moment of time the agreement was made, but becomes impossible or unlawful afterwards, the contract becomes void when the act becomes impossible or unlawful.

ILLUSTRATIONS

- (a) A agrees with B to discover treasure by magic. The agreement is void.
- (b) A and B contract to marry each other. Before the time fixed for the marriage, A goes mad. The contract becomes void.
- (c) A contracts to marry B, being already married to C, and being forbidden by the law to which he is subject to practise polygamy. A must make compensation to B for the loss caused to her by the non-performance of his promise.

⁷ *Manubhai v. Keshavji*, 24 Bom. L.R. 60.

⁸ *Prithi Singh v. Matu Ram* (1932) 13 Lah. 766.

(d) *A* contracts to take in cargo for *B* at a foreign port. *A*'s Government afterwards declares war against the country in which the port is situated. The contract becomes void when war is declared.

(e) *A* contracts to act at a theatre for six months in consideration of a sum paid in advance by *B*. On several occasions *A* is too ill to act. The contract to act on those occasions becomes void.

Initial and Supervening Impossibility: The law both in *England* and *India* on the question of physical impossibility at the moment of time the contract was entered into is the same, viz. that the agreement is void *ab initio*. On the point of subsequent or supervening impossibility, there is a difference between the English and the Indian Law. According to the Indian law, if the act was possible or lawful at the time of entering into the agreement but a subsequent event makes it impossible or unlawful, and if that event is one which the promisor could not prevent, then also the agreement becomes void. In *English Law*, if an agreement is possible of performance at the time it is entered into, but an impossibility arises afterwards, that in itself is not an excuse for non-performance unless expressly so stipulated. However, in particular and exceptional cases where the event which brought about the impossibility is of such a nature that it cannot reasonably be supposed to have been in the contemplation of the parties when the contract was entered into, the plea of subsequent impossibility may be successfully raised. Examples of such cases are where performance becomes illegal through an alteration of law, or where an event fails to occur or a state of things ceases to exist which formed the foundation on which the contract was based, or where a contract for personal service is rendered impossible by the death or incapacity of the promisor, or in the case of the destruction of a specific object the existence of which is necessary for the performance of the contract.

Frustration

A special case of supervening impossibility is known as "*Frustration*". In Anson's words, it occurs "where, through supervening circumstances, performance becomes impossible within the time, or in the manner contemplated by the parties", e.g. dislocation of business in consequence of war.

In *English Law* the doctrine of "frustration of adventure" is based on the doctrine of the implied term in a commercial contract. For example, where a supervening event such as the seizure of the ship by the enemy in time of war and internment of the crew for an

indefinite period was held to put an end to the obligation of the shipowner to continue paying the wages of the seamen.⁹

In *India* the doctrine of frustration is a part of the law of supervening or subsequent impossibility where an unexpected event or change of circumstances frustrates the very purpose or basis of the contract. It is not based on the English doctrine of the implied term. In *Satyabrat Ghose v. Mugneeram Bangur & Co.*,¹⁰ the Supreme Court laid down that Courts in India should look primarily to the law in Sections 32 and 56 of the Indian Contract Act. "The essential idea upon which the doctrine of frustration is based is that of impossibility of performance of the contract. In fact impossibility and frustration are often used as interchangeable expressions. The changed circumstances make performance of the contract impossible and the parties are absolved from the further performance of it as they did not promise to perform an impossibility".

Commercial Impossibility

In order to be excused on the ground of frustration, a party to the contract must prove that the act or promise has become actually impossible of performance.

Mere difficulty of performance or '*commercial impossibility*' is no excuse. For example, in one case *A* had entered into a contract to carry goods from Bombay to Antwerp, shipment to be made in September. Owing to the outbreak of war *A* could not perform the contract, as the freight from Bombay to Antwerp could only be procured at an exorbitant rate. However, it was held that this was not impossibility sufficient to excuse performance of the contract as contemplated by the Indian Contract Act.¹¹ Even strikes and resultant stoppage of work has been regarded as insufficient to render a contract impossible of performance.¹²

Effect of War on Contracts

Effect of War on contracts with aliens has already been dealt with sufficiently earlier in the book. Briefly, the position is that agreements entered into with *alien enemies during war* are *void ab initio*. Those entered into during peace are either *suspended* during hostilities or *entirely dissolved* where it amounts to aiding the enemy.

⁹ *Horlock v. Beal*, (1916) I.A.C. 486

¹⁰ (1954) S.C. 44

¹¹ *Karl Ettiner v. Changandas & Co.*, 40 Bom. 301

¹² *Hari Laxman v. Secretary of State* (1927) 30 Bom. L.R. 49

Compensation or Refund in cases of Impossibility

Further in case of such agreements, if one of the parties, who *knew* or with reasonable diligence might have known at the time of the agreement that the agreement was unlawful or impossible, enters into the contract without letting the other party know of it, and the other party does not know of it, then the party who knows of this fact would have to *compensate* the other party for any loss which that party suffers through the non-performance of the agreement (S. 56).

When the contract becomes impossible afterwards or is discovered to be void, any person who has *received any advantage* therefrom is bound to *restore it or to make compensation* for it to the person from whom he received it (S. 65). Thus a party who has paid any amount as a security or deposit in such a contract would be entitled to recover it in the event of the contract becoming impossible.

ILLUSTRATION

If *A* contracts to sing for *B* at a concert for 1,000 rupees which were paid in advance and *A* is too ill to sing, *A* is not bound to make compensation to *B* for the loss of profits which *B* would have made if *A* had been able to sing, but must refund to *B* the 1,000 rupees paid in advance (ill. to S. 65)

Formerly in *English Law*, the person who had received any advantage under a contract which subsequently became void was not bound to restore it and he could in addition demand the balance due.¹³ Later these decisions were over-ruled by the House of Lords who held that an action for the recovery of money paid could be maintained on the ground of failure of consideration.¹⁴

In the same year the Law Reform (Frustration of Contracts) Act, 1943 was passed. It provides that where a contract governed by *English Law* has become impossible of performance or is otherwise frustrated and the parties thereto have been released from further performance all sums paid by one of the parties to the other are recoverable. It further provides that if the party to whom the sums were paid or payable has incurred any expenses, he may be allowed to retain or recover them where the court considers it just. That Act does not apply to (1) contracts which contain a provision for frustration, (2) charterparties which are not time charterparties or charterparties by way of demise, (3) contracts for the carriage of goods by sea, (4) contracts of insurance, (5) contracts for the sale

¹³ *Candler v. Webster* (1904), 1 K. B. 493

¹⁴ *Fibrosa Spolka Akcyjna v. Fairbairn Lawson Combe Barbour, Ltd.* (1943) A.C.32

of specific goods which are destroyed before the risk has passed to the buyer.

SUMMARY

Agreements Not Declared Void: One of the essentials of a valid agreement is that it should not have been declared void by any law in force in India.

Void Agreements: The Indian Contract Act has declared *void agreements*—

1. by persons who have *no legal capacity* to contract
2. entered into through *mistake* of fact
3. the *object* or consideration of which is unlawful
4. *part* of the *object* or consideration of which is *unlawful*
5. made *without consideration*
6. in *restraint of marriage*
7. in *restraint of trade*
8. in *restraint of legal proceedings*
9. which are *uncertain*
10. *wagering* agreements
11. *impossible* agreements

Definition of Wager: "A promise to give money or money's worth upon the determination or ascertainment of an uncertain event."
—Anson

Impossible Agreements: Impossibility may be

1. Physical
2. Legal
3. *Ab initio* (from the beginning)
4. Supervening or subsequent.

Initial (*ab initio*) Impossibility: If the agreement is impossible of performance either *physically* e.g. to marry a person who is already dead, or *legally* e.g. to buy foreign currency without the proper authority, the agreement is void from the beginning *i.e.* void *ab initio* and this is so whether the impossibility of performance was known to the parties at the time they entered into the agreement. If, however, the promisor alone knew of the impossibility he would have to compensate the other party. The law in *England* and India is the same as regards impossibility *ab initio*.

Supervening Impossibility: When the contract is possible of performance at the time it is entered into but a subsequent event makes it impossible of performance, the Indian Law, as we have seen already, makes the contract void under Section 56.

In *English Law*, however, mere subsequent impossibility was formerly no excuse for non-performance. Only if the supervening impossibility was expressly stipulated as a ground for avoiding the

contract was non-performance excused. Later, this strict rule of English Law was relaxed by the doctrine of frustration.

Frustration: In *English Law* the doctrine of frustration is based on the doctrine of an implied term in the contract. In *Indian Law* it is a case of supervening impossibility and is governed by Section 56.

Commercial Impossibility: Commercial impossibility means that the contract is physically and legally capable of performance but in performing it the promisor would be put to extra expense making the performance uneconomical. Commercial impossibility does not make the contract void.

Effect of War on Contracts

1. If the agreement was made with an alien enemy *during* war it is void *ab initio*.
2. If it was made *before* war was declared between the countries of the contracting parties it is—
 - (a) *suspended*, to be revived when war ceases, or
 - (b) *dissolved* entirely if it is likely to aid the enemy's war efforts.

Compensation or Refund

1. When *one of the parties knew* of the impossibility or illegality at the time of the agreement or with reasonable diligence might know, he must make *compensation* to the other party for any loss the latter may have sustained through non-performance (S.56).
2. When an agreement is either discovered to be void or a contract becomes void subsequently, any party who has received any advantage under such agreement or contract must restore it or make compensation to the other party for any loss he may have suffered through such non-performance.

TYPICAL QUESTIONS

1. (a) How far are rights and liabilities of parties to a contract affected by supervening impossibility?
 (b) A sued B for rent due upon a lease. B pleaded that an alien enemy had invested the realm with a hostile army of men and with some force entered upon the land in possession of B and expelled him whereby he could not take the profits and pay the rent. Discuss the validity of this defence of B under (i) Indian law, (ii) English law.
2. Write short notes on:
 - (a) Wagering Agreement.
 - (b) Impossibility of Performance
 - (c) Void Agreements
3. (a) During his wife's lifetime F promised to marry G when his wife died. The wife died and F refused to marry G. Advise G whether she has any remedy.
 (b) D falsely pretends to E that D is a bachelor and persuades E to get engaged to himself. D is in fact married. Has E any remedy when she discovers the truth.

Chapter 10

CONTRACTS Contingent

CONTRACTS may be classified as—

1. Absolute, *i.e.*, to be performed irrespective of any contingency.
2. Conditional or Contingent, *i.e.*, dependent on some event. All conditional contracts are not, however, contingent, as we shall see later.

A “contingent contract” is a contract to do or not to do something, if some event, collateral to such contract, does or does not happen (S. 31).

ILLUSTRATION

A contracts to pay B Rs 10,000 if B's house is burnt. These contracts cannot be enforced unless and until the contingent event happens (S. 31). A wager is a contingent agreement but as it is declared void by Section 30 a wager is not a contingent contract.

Often contracts are entered into which are enforceable on the happening of some event or contingency, e.g., an insurance contract where an insurance company agrees to pay a certain amount on the

destruction, or damage of the property insured. A builder's right to recover his bill for the work actually done is frequently made by agreement contingent on the architect certifying it as satisfactory, and so on.

These contingent contracts are good if the contingency provided for was not impossible at the moment the contract was made.

ILLUSTRATION

Where *A* says to *B*, "I shall pay you Rs 1,000 if you marry *C*'s only daughter", and where *C*'s only daughter was dead before *A* said this, the contract is void because the contingency was in itself impossible at the very inception, *i.e.*, *ab initio*.

If on the other hand, the contingency was not impossible at the moment of time the contract was entered into, but subsequent events make it impossible, the contract becomes void from that moment.

ILLUSTRATION

Where *A* contracts to pay *B* Rs 1,000 if he marries *C*, the contract becomes impossible from the moment of time *C* dies unmarried and the contract is thus void from that time. But if *C* does not die but marries some other man, say *D*, then, also as provided by Section 34, the contract may be taken to have become impossible and void even though there is the remote possibility of *D* dying during the lifetime of *B* and *C* and of *B* marrying *C* thereafter. On the same principle, if a period is fixed during which the contingency has to happen, the contract becomes void and impossible on the expiration of that period.

Contracts of insurance, indemnity and guarantee are examples of contingent contract but although wagers are contingent agreements they are not contracts because they are declared void by the Indian Contract Act.

Essentials of a Contingent Contract

1. The performance of a contingent contract will depend on a future event.
2. The happening of the event must be uncertain.
3. The uncertain event must be a collateral or incidental event and not part of the promise. For example if *A* promises to pay *B* a certain sum for painting *A*'s car with a condition that payment will be made only after the job is complete, this is not a contingent contract, though a conditional one, because the condition on which the payment depends is the very act contracted for and not a collateral event.

Rules Regarding Contingent Contracts

The rules regarding contingent contracts are found in Sections 32 to 36.

1. Contingent contracts to do or not to do anything if an uncertain future event happens cannot be enforced by law unless and until that event has happened.

If the event becomes impossible such contracts become void (S. 32).

Thus a contingent contract is enforceable only on the happening of the uncertain event and if the event becomes impossible, contract becomes void.

ILLUSTRATIONS

(a) *A* makes a contract with *B* to buy *B*'s horse if *A* survives *C*. This contract cannot be enforced by law unless and until *C* dies in *A*'s lifetime.

(b) *A* makes a contract with *B* to sell a horse to *B* at a specified price, if *C*, to whom the horse has been offered, refuses to buy it. The contract cannot be enforced by law unless and until *C* refuses to buy the horse.

(c) *A* contracts to pay *B* a sum of money when *B* marries *C*. *C* dies without being married to *B*. The contract becomes void.

2. Contingent contracts to do or not to do anything if an uncertain future event does not happen can be enforced when the happening of that event becomes impossible and not before (S. 33).

ILLUSTRATION

A agrees to pay *B* a sum of money if a certain ship does not return. The ship is sunk. The contract can be enforced when the ship sinks.

3. If the future event on which a contract is contingent is the way in which a person will act at an unspecified time, the event shall be considered to become impossible when such person does anything which renders it impossible that he should so act within any definite time, or otherwise than under further contingencies (S. 34).

ILLUSTRATION

A agrees to pay *B* a sum of money if *B* marries *C*. *C* marries *D*. The marriage of *B* to *C* must now be considered impossible although it is possible that *D* may die and that *C* may afterwards marry *B*.

4. Contingent contracts to do or not to do anything if a specified uncertain event happens within a fixed time become void if, at the expiration of the time fixed, such event has not happened or if, before the time fixed, such event becomes impossible (S. 35).

5. Contingent contracts to do or not to do anything if a specified uncertain event does not happen within a fixed time may be enforced by law when the time fixed has expired and such event has not happened or, before the time fixed has expired, if it becomes certain that such event will not happen.

ILLUSTRATIONS

(a) *A* promises to pay *B* a sum of money if a certain ship returns within a year. The contract may be enforced if the ship returns within the year, and becomes void if the ship is burnt within the year.

(b) *A* promises to pay *B* a sum of money if a certain ship does not return within a year. The contract may be enforced if the ship does not return within the year, or is burnt within the year.

6. Contingent agreements to do or not to do anything if an impossible event happens are void, whether the impossibility of the event is known or not to the parties to the agreement at the time when it is made.

ILLUSTRATIONS

(a) *A* agrees to pay *B* Rs 1,000 if two straight lines should enclose a space. The agreement is void.

(b) *A* agrees to pay *B* Rs 1,000 if *B* will marry *A*'s daughter, *C*. *C* was dead at the time of the agreement. The agreement is void.

SUMMARY

Definition: A contingent contract is a contract to do or not to do something, if some event, collateral to such contract, does or does not happen (S. 31).

Rules as to Contingent Contracts

1. Contingent contracts to do or not to do anything if an uncertain future event happens cannot be enforced by law unless and until that event happens.

2. Contingent contracts to do or not to do anything if an uncertain future event does not happen can be enforced when the happening of that event becomes impossible, and not before.

3. If the future event on which a contract is contingent is the way in which a person will act at an unspecified time, the event will be considered to become impossible when such person does anything which renders it impossible for him to act in that manner.

4. Contingent contracts to do or not to do anything if a specified uncertain event happens within a fixed time becomes void if, at the expiry of the fixed time, such event does not happen or before the

fixed time has expired, it becomes certain that such event will not happen.

5. Contingent agreements to do or not to do anything if an impossible event happens, are void, whether or not the impossibility of the event is known to the parties to the agreement at the time it was made.

6. Agreements which are contingent on impossible events are void.

TYPICAL QUESTIONS

1. What do you mean by contingent contracts? Explain their validity.
2. (a) What is Contingent Contract?
(b) When can a party enforce such Contract?
3. Are the following contracts contingent contracts? How will you decide them?
(a) *A* agrees to pay *B* Rs 500, if *C* passes his LL.B. examination in 1972. *C* passes his examination in 1972.
(b) *A* agrees to pay *B* Rs 500 if SS. Orlando does not return within the year. The ship is sunk within the year.
(c) *A* agrees to pay *B* Rs 500 if *B* will marry his own daughter *C*. *C* was dead at the time of agreement.
4. (a) During his wife's lifetime *A* promised to marry *B* when his wife died. The wife died and *A* refused to marry *B*. Advise *B* whether she has any remedy.
(b) *A* contracts to pay *B* a sum of money when *B* marries *C*. *C* dies without being married to *B*. Advise *A*.
5. (a) Discuss the principles underlying contingent contracts.
(b) *A* insures the life of *B*, a wife of his clerk. *B* dies. Is *A* entitled to claim under the Insurance Policy? Why?

Chapter 11

CONTRACTS Termination

CONTRACTS may be terminated or discharged by any one of the following methods:—

- (1) By Agreement (Novation, Accord and Satisfaction, Waiver, Remission, Rescission, Alteration).
- (2) By Fulfilment or Performance.
- (3) By Breach.
- (4) By Lapse of Time.
- (5) By Impossibility. (Frustration)
- (6) By Operation of Law. (Death, insolvency, merger)

(1) BY AGREEMENT

The important ways in which contracts are terminated by agreement will now be detailed.

Novation

The law with regard to novation is explained by Section 62 of the Indian Contract Act. "If the parties to a contract agree to subs-

stitute a new contract for it, or to rescind or alter it, the original contract need not be performed". The term "novation" implies the substitution of a new contract for the old one, between the same or between different parties, the consideration being the discharge of the old contract.¹ The usual and the most common form of novation is substituting a new debtor in place of an old one with the consent of the creditor, *e.g.* *A* owes money to *B* under a contract. It is agreed between *A*, *B* and *C* that *B* shall henceforth accept *C* as his debtor instead of *A*. The old debt of *A* to *B* is at an end, and a new debt from *C* to *B* has been contracted. The most essential point in the case of novation is that the original debtor goes out and the liability of the new contracting party is accepted in his place.²

Accord and Satisfaction

According to *English Common Law* consideration is necessary both for the *formation* as well as the *discharge* of a contract unless the agreement is by deed. Therefore, in order to discharge an existing obligation under a contract *accord* and *satisfaction* are necessary. By accord is meant an agreement, between the parties to the original contract, to do something different from what was required by the contract. The accord is satisfied when the new agreement is performed. Thus in Accord and Satisfaction, Accord is the new agreement and Satisfaction is its performance. Where a creditor is paid earlier and he agrees to take it and allows a discount to the debtor there is an agreement falling under this head. Also where there is a dispute as to the amount due on a contract and a settlement is reached or where a compromise is made under a deed or arrangement in insolvency there is an accord and satisfaction.

A Right to Sue on Original Consideration in case of a Bill or Note

In this connection it should be noted that where a cause of action is once complete in itself and then the debtor gives a promissory note or accepts a bill the creditor has a right to sue either on the note or bill or on the original consideration, *e.g.* where *A* sells goods to *B* and thereafter *B* gives *A* promissory note or accepts *A*'s draft, *A* has the option either to sue on the bill or the note or, if for some reason he cannot do so (say the bill is improperly stamped), to sue *B* on the original consideration *viz.*, the goods sold and delivered. Where, however, the original consideration is the bill or note as where it is given in consideration of a loan of money made against it, there is only one cause of action.

¹ *Scarfe v. Jardine* (1882) 7 A.C. 345

² *Nadimulla v. Chanapa*, 5 Bom. L.R. 617

Remission

“Every promisee may dispense with or remit, wholly or in part, the performance of the promise made to him, or may extend the time for performance or may accept instead of it any satisfaction he may think fit. (S. 63). Thus a contract may be discharged by remission of performance or extension of time or by the acceptance of any other satisfaction by the promisee.

ILLUSTRATIONS

(a) *A* promises to paint a picture for *B*. *B* afterwards forbids him to do so. *A* is no longer bound to perform the promise.

(b) *A* owes *B* Rs 5,000. *A* pays to *B* and *B* accepts, in satisfaction of the whole debt, Rs 2,000 paid at the time and place at which the Rs 5,000 were payable. The whole debt is discharged (ills. to S. 63).

Here the law differs from the English Law because in *English Law* as we have seen under *Accord and Satisfaction*, every release must be either by deed or supported by consideration whereas our Indian Law does not require consideration or a new agreement to support a remission of performance.

Arising from the rule laid down by this section, an agreement to extend the time for the performance of an agreement also does not require consideration in India to support it on the ground that it is a partial remission of performance. There must be *an agreement* to extend the time for performance as mere forbearance to sue is not covered by Section 63.

Rescission

When a person at whose option a contract is voidable rescinds it, the other party need not perform his promise and the party who rescinds must *restore* the benefit which he may have received under the contract. This is provided by Section 64. The principle behind this is that “no man can at once treat the contract as avoided by him, so as to resume the property which he parted with under it, and at the same time keep the money or other advantage which he has obtained under it”.³

The *benefit* which is to be restored must have been *received under the contract*. For example, if an amount has been handed over by *A* to *B* as a deposit to be forfeited if *A* does not complete the contract, such deposit is not to be returned as it is not a benefit received under

³ *Clough v. L. & N.W.R.* (1871) L.R. 7 Ex. 27

the contract but by way of security for the due performance of the contract.

When a contract has been rescinded under Section 39 *i. e.* on refusal of the other party to perform his promise wholly, the party rescinding must return any benefit received under the contract but he will, of course, be entitled to claim damage from the defaulting party for breach of contract. The exact words of Section 39 are, "when a party to a contract has refused to perform, or disabled himself from performing his promise in its entirety, the promisee may put an end to the contract unless he has signified, by words or conduct, his acquiescence in its continuance".

A contract may also be rescinded on the ground of fraud, undue influence, etc. as we have already seen.

The rescission of avoidable contract may be communicated or revoked in the same manner, and subject to the same rules, as apply to the communication or revocation of a proposal (S. 66).

Alterations in a Contract

If an alteration is made in a contract with the *consent of all* the parties to the contract the original contract need not be performed (S. 62); but the new contract in its altered form takes its place. If, however, one of the parties to the contract, while the contract is in his custody, makes an alteration, *without the consent of the other party* either by erasure or addition, and *if that alteration is material*, the result is that the whole contract is discharged in so far as he is concerned. The consequence is the same if a stranger made this alteration while the document was in the possession of a party to the contract. The *only* exception that can be pleaded in such a case is that the alteration was made through a mistake or accident. A *material alteration* is one which alters the legal effect of the contract. Thus where the date of a bond was altered the alteration was material and it was held to avoid the bond.⁴ Similarly, an alteration on a bill of exchange from D. P. to D. A. was held to be a material alteration which avoided the contract.⁵

Assignment of Contracts

Generally speaking, the *benefits* of contracts can be assigned but *not* the *liability* or *burden*. Our Indian Contract Act has no Section dealing with the assignment of contracts.

⁴ *Gogun Chunder Ghose v. Dhuronidhur* (1881), Cal. 616

⁵ *Mesha Ahronel v. The National Bank of India* (1903), 5 Bom. L.R. 524

In *England*, however, under the Judicature Act⁶, a creditor may assign his claim or a person who has a right on any property may assign such right unless the assignment constitutes the alteration of the burden which the contract throws on the assignor. Such an assignment must be (1) *absolute and not by way of charge* (2) *in writing* which must be signed by the assignor and (3) *written* notice must be given to the debtor of such assignment. No consideration is necessary and the assignee takes *subject to equities*. i.e. the transferee is in no better position than his transferor. In other words the Act makes effectual the assignment of a legal *close in action* and enables the assignee to sue in his own name. A *close in action* is a personal right on property which can only be claimed or enforced by action and not by taking physical possession. There are contracts such as those of policies of life and marine insurance which are assigned under special Acts. Bills of lading are assignable in English Law under the Bills of Lading Act, 1885 and in Indian Law under the Indian Bills of Lading Act, 1856 and a bill of exchange or a negotiable instrument is transferable or assignable under the Bills of Exchange Act of England and the Negotiable Instruments Act of India.

There may be devolution or assignment by death or insolvency. This is called assignment by operation of law. In case of death the property of a person devolves on his executors if he has died leaving a will naming the executors in it or failing that to his administrators. On the same principle, by the operation of the law of insolvency, on the adjudication of an insolvent debtor all his property vests in the official assignee in India or the official receiver, or trustee in bankruptcy in England, and in England if a person is convicted of felony or treason his rights of action during his disability as well as those existing at the time of his conviction vest in an administrator appointed by the Crown.

An *actionable claim* can always be assigned in India but the assignment in order to be complete and effectual must be made by *an instrument in writing*. In India, the transfer of an actionable claim does not require notice to the debtor, to be complete and effectual (S. 130, *Transfer of Property Act*). It has also been held in India that the interests of a buyer of goods in a contract for forward delivery can be assigned and that such an interest constitutes an actionable claim within the meaning of the Transfer of Property

⁶ Now repealed by the *Law of Property Act, 1925*

Act.⁷ But once a contract is broken a *mere right* to sue for damages *cannot* be assigned either in English or Indian law.

It also happens that a contract may contain a clause in which it is clearly provided that, on the happening of a certain event the contract is to terminate, then in such a case the happening of the event contemplated brings such a contract to an end and discharge the parties concerned as provided for in the agreement.

(2) BY FULFILMENT OR PERFORMANCE

Fulfilment or Performance of a contract ought to be strictly in accordance with the requirements of law as laid down in Sections 37 to 67 of the Indian Contract Act. Section 37 clearly states that in order to claim performance the parties to a contract must have *actually performed* what they had undertaken to do under the contract, or must have shown that all the time they were ready and *willing to perform* their respective promises. In case where the promise is of a nature that by implication, or by the nature of the contract, personal performance is agreed upon then the person concerned must actually perform or must be willing and ready to perform his part personally. He cannot in such a case delegate his work to others.

The law expects every person who claims to *sue on* a contract on the ground that he performed his part, or was ready and willing to do so, *to prove*:

(1) that his performance or offer of performance was *unconditional*,

(2) that it was *made at a proper time and place* and that the person to whom it was made had a *reasonable opportunity to ascertain such a willingness*, and

(3) if the performance constituted the *delivery* of anything, it must be shown that the other party was given a *reasonable opportunity of seeing that the thing offered* was the *thing which the promisor* had bound himself with the promise to deliver.

Valid Tender

An offer to one of several joint promisees has the *same legal consequence* as an offer to all of them. Where the performance is by *payment*, the payment must be *absolute* and of the *exact amount due*

⁷ *Jaffer Meherali v. Budge Budge Jute Mill Co.* (1906), 33 Cal. 702 affirmed in 34 Cal. 289, *Hansraj Morarji v. Nethoo Gangaram* (1907), 9 Bom. L.R. 838

in the *legal tender* money of the country. Besides this the money should *actually be shown*, as a mere letter offering to pay would not amount to a valid tender. The *tender* should be made at the *proper time and place*. If a cheque is offered in payment a creditor is not bound to accept it; but if he once accepts, it will be a valid tender and that fact cannot afterwards be taken as a ground for not performing the contract. Where the *order* in which reciprocal promises are to be performed is expressly fixed by the contracts that order must be followed, if not the order which the nature of the transaction requires may be followed (S. 52).

When Time is of the Essence of the Contract

We have seen that a contract must be *performed* at the *proper time and place*. The *contract* generally *fixes the time* at or before which the agreement has to be *performed* and thus *time is said to be made the essence of the contract*. In such a case failure to perform his part of the contract by one of the parties within the specified time limit makes the contract or so much of it as has been performed, voidable at the option of the injured party. If, on the other hand, it was *not intended that time* was to be of the essence of the contract, *though the date was specified*, the failure to perform will not make the contract voidable at the option of the other side, but all that the injured party will be entitled to are damages or compensation (S. 55).

This *rule as to the intention* of the parties to make time the essence of the *contract applies differently in cases* of contracts for the *sale of land* and those for the *sale of merchandise*. In the case of the former the intention has to be expressed in un-mistakable language, as otherwise, equity presumes that the time of *performance* was not intended to be of importance. In *mercantile or commercial contracts*, however, the *presumption* is quite the other way. When merchants mention time and dates in their contracts they are taken to mean and intend that the stipulation has to be carried out. It is well settled that in contracts other than mercantile ones, stipulations as to time are, in the absence of express or implied proof of the contrary, not to be of the essence of the contract. On the other hand, in a mercantile contract, ordinarily, time constitutes the essence of the contract, the reason being that a mercantile contract is not always an isolated transaction, but constitutes a link in the chain of transactions which the parties enter into in the course of their business with others.³

³ *Sahu & Co. v. Sriram Vijay Kumar*, 1971 (2) C.W. . 86

By Whom Contracts must be Performed

Sections 40 to 45 deal with the question of by whom promises under a contract are to be performed and the devolution of joint liabilities and rights. The term *promise* is used in the Indian Contract Act to mean an *accepted proposal*.

(1) Personal Contracts

In the case of *personal contracts*, such as those which require the exercise of personal skill and diligence, the *promisor himself* must perform his promise. (S. 40).

ILLUSTRATION

A promises to paint a picture for *B*. *A* must perform this promise personally.

(2) Other Contracts

In *other cases*, i.e., in the case of contracts which do not depend on personal considerations, either the *promisor* or his duly authorised *agent* may perform the promise. (S. 40).

ILLUSTRATION

A promises to pay *B* a sum of money. *A* may perform this promise, either by personally paying the money to *B* or by causing it to be paid to *B* by another; and, if *A* dies before the time appointed for payment, his representatives must perform the promise, or employ some proper person to do so.

Death of Promisor

On the *death* of the promisor the liability for performance devolves on his *representatives* unless a contrary intention appears from the contract (S. 37).

ILLUSTRATION

A promises to deliver goods to *B* on a certain day on payment of Rs 1,000. *A* dies before that day. *A*'s representatives are bound to deliver the goods to *B* and *B* is bound to pay the Rs 1,000 to *A*'s representatives.

The representatives of the deceased would be the executors named in the will or administrators of the deceased's estate. The liability of such representatives is limited to the estate of the deceased which has come into their hands.

The *exception* is where the contract is of such a personal nature that performance by representatives will not be according to the intention of the parties to the contract.

ILLUSTRATION

A promises to paint a picture for *B* on a certain day at a certain price. *A* dies before that day. The contract cannot be enforced either by *A*'s representatives or by *B*.

(4) *Third Party*

If the promisee accepts performance from a third party, he cannot afterwards enforce it against the promisor (S. 41).

(5) *Devolution of Joint Promises*

(a) All the joint promisors are liable during their lifetime to perform the promise.

(b) When two or more persons have made a joint promise the promises may, in the absence of a contract to the contrary, compel any one or more of such joint promisors to perform the whole of the promise. Each of the joint promisors may, however, compel every other joint promisor to contribute equally with himself to the performance unless a contrary intention appears from the contract.

(c) If one or more of the joint promisors have been released by the promisee, the promise must be performed by those who are not so released (S. 44).

(d) In the case of death of any joint promisor the survivors together with the representative of the deceased promisor must perform the promise (S. 42).

(e) After the death of the last surviving joint promisor, the representatives of all jointly must perform it (S. 42).

Contribution by Joint Promisors

Every joint promisor has the right to compel every other joint promisor to contribute equally with himself to the performance of the promise, unless a contrary intention appears from the contract.

If, however, any joint promisor fails to make such contribution the remaining joint promisors must bear the loss arising from such default in equal shares. This rule, however, does not prevent a surety from recovering from his principal, payments made by the surety on behalf of the principal, nor entitle the principal to recover anything from the surety on account of payments made by the principal (S. 43).

ILLUSTRATIONS

(a) *A*, *B* and *C* jointly promise to pay *D* Rs 3,000. *D* may compel either *A* or *B* or *C* to pay him Rs 3,000.

(b) *A, B and C jointly promise to pay D the sum of Rs 3,000. C is compelled to pay the whole. A is insolvent, but his assets are sufficient to pay one-half of his debts. C is entitled to receive Rs 500 from A's estate, and Rs 1,250 from B.*

(c) *A, B and C are under a joint promise to pay D Rs 3,000. C is unable to pay anything, and A is compelled to pay the whole. A is entitled to receive Rs 1,500 from B.*

(d) *A, B and C are under a joint promise to pay D Rs 3,000, A and B being only sureties for C. C fails to pay. A and B are compelled to pay the whole sum. They are entitled to recover it from C.*

Devolution of Joint Rights

When there are *joint promisees, i.e.*, when a person has made a promise to two or more persons jointly, then unless a contrary intention appears from the contract, the right to claim performance rests, as between him and them,

(a) with them during their joint lives, and

(b) after the death of any of them, with the representative of such deceased person jointly with the survivor or survivors, and,

(c) after the death of the last survivor, with the representative of all jointly (S. 45).

ILLUSTRATION

A, in consideration of Rs 5,000 lent to him by B and C, promises B and C jointly to repay them that sum with interest on a day specified. B dies. The right to claim performance rests with B's representative jointly with C during C's life, and after the death of C with the representatives of B and C jointly.

Rules as to Performance of Reciprocal Promises

This term *promise* is used in the Indian Contract Act to mean an *accepted proposal*.

Sections 52 to 54 deal with the performance of *reciprocal promises, i.e.*, when the consideration of each party to the contract consists of a promise.

The following are the *rules as to performance of reciprocal promises*—

1. If the contract consists of reciprocal promises which are *to be performed simultaneously* neither party is bound to perform his promise unless the other party is ready and willing to perform his reciprocal promise (S. 51).

ILLUSTRATIONS

(a) *A and B contract that A shall deliver goods to B to be paid for by B on delivery. A need not deliver the goods, unless B is ready and willing to pay for the*

goods on delivery. *B* need not pay for the goods, unless *A* is ready and willing to deliver them on payment.

(b) *A* and *B* contract that *A* shall deliver goods to *B* at a price to be paid by instalments, the first instalment to be paid on delivery. *A* need not deliver, unless *B* is ready and willing to pay the first instalment on delivery. *B* need not pay the first instalment, unless *A* is ready and willing to deliver the goods on payment of the first instalment.

2. If the *order* in which the reciprocal performances are to be performed is *fixed by the contract*, they must be performed in that order (S. 52).

3. If the *order* in which the reciprocal promises are to be performed are *not fixed by the contract*, they must be performed in the order which the *nature of the transaction* requires (S. 52).

ILLUSTRATIONS

(a) *A* and *B* contract that *A* shall build a house for *B* at a fixed price. *A*'s promise to build the house must be performed before *B*'s promise to pay for it.

(b) *A* and *B* contract that *A* shall make over his stock-in-trade to *B* at a fixed price, and *B* promises to give security for the payment of the money. *A*'s promise need not be performed until the security is given, for the nature of the transaction requires that *A* should have security before he delivers his stock.

4. If *one* of the parties to a contract of reciprocal promises *prevents* the other party from performing his promise, the contract becomes *voidable* at the option of the party so prevented. Such party is also entitled to *compensation* from the other party for any loss which he may sustain in consequence of the non-performance of the contract (S. 53).

ILLUSTRATION

A and *B* contract that *B* shall execute certain work for *A* for a thousand rupees. *B* is ready and willing to execute the work accordingly, but *A* prevents him from doing so. The contract is voidable at the option of *B*; and, if he elects to rescind it, he is entitled to recover from *A* compensation for any loss which he has incurred by its non-performance.

5. If the reciprocal promises are such that *one of the promises should be first performed* otherwise the other promise cannot be performed, if the first promise is not performed such promisor cannot claim the performance of the reciprocal promise, and must make *compensation* to the other party to the contract for any loss which such party may sustain by the non-performance of the contract (S. 54).

These are cases of reciprocal promises where the performance of one is *dependent* on the performance of the other.

ILLUSTRATIONS

(a) *A* hires *B*'s ship to take in and convey, from Calcutta to Mauritius, a cargo to be provided by *A*, *B* receiving a certain freight for its conveyance. *A* does not provide any cargo for the ship. *A* cannot claim the performance of *B*'s promise, and must make compensation to *B* for the loss which *B* sustains by the non-performance of the contract.

(b) *A* contracts with *B* to execute certain builder's work for a fixed price, *B* supplying the scaffolding and timber necessary for the work. *B* refuses to furnish any scaffolding or timber, and the work cannot be executed. *A* need not execute the work, and *B* is bound to make compensation to *A* for any loss caused to him by the non-performance of the contract.

(c) *A* contracts with *B* to deliver to him, at a specified price, certain merchandise on board a ship which cannot arrive for a month, and *B* engages to pay for the merchandise within a week from the date of the contract. *B* does not pay within the week. *A*'s promise to deliver need not be performed, and *B* must make compensation.

(d) *A* promises *B* to sell him one hundred bales of merchandise, to be delivered next day, and *B* promises *A* to pay for them within a month. *A* does not deliver according to his promise. *B*'s promise to pay need not be performed, and *A* must make compensation.

Appropriation of Payments

Where there are *several distinct debts* owing by one person to another and the debtor makes a payment which is insufficient to discharge all the debts, the rule is that in the first instance it is the *option of the debtor* to appropriate his payment to any of his debts he chooses. When the debtor does that expressly, or by implication, the creditor is bound to appropriate accordingly, if he accepts this payment, otherwise he should refuse to accept the payment altogether; but he cannot receive the payment under protest (S. 50).

The words "*Several distinct debts*" should be noticed as the section does not apply where there is only one debt although it may be payable by instalments. This section incorporates the *rule in Clayton's case*. This rule is carried further, *e.g.* if a creditor has received money belonging to a debtor, without the debtor's knowledge, the debtor shall have the right to appropriate it to whatever debt he chooses within a reasonable time of his (debtor's) coming to know of it.

If, however the *debtor omits* to appropriate and there is nothing to show from the nature of the payment or other circumstances as to what debt the amount is to be appropriated, the *creditor may appropriate* this amount to any *lawful debt* actually due and payable including a debt which is barred by the Limitation Act (S. 60).

ILLUSTRATION

Three simple debts are owed by *A* to *B*, viz: (1) a debt which fell due in 1905 for Rs 500; (2) another for Rs 1,500 due in 1910; and (3) another for Rs 5,000 due in 1917. *A* pays a cheque to *B* for Rs 3,000 in 1917. If he expressly states that the amount is to be appropriated to the debt of 1917, *B* must do so. but if by some chance he omits to do so, *B* may appropriate this amount first to write off Rs 500 for 1905, plus Rs 1,500 for 1910 and appropriate the balance of Rs 1,000 only to the debt of 1917, and then give notice of his having done so to *A*. After this, it would be too late for *A* to object.

It should be here noted that the creditor cannot appropriate any payment made by the debtor to an illegal or void debt, though he can appropriate to any unenforceable or time barred debt.⁹ The creditor need not act at once. He may exercise this right of appropriation even at the very last moment but once he has made an appropriation and informed the debtor he cannot appropriate it otherwise.¹⁰ When the money is due both for *principal and interest* where the appropriation is made by the creditor, it is considered to be an appropriation first towards interest and then towards principal.¹¹

The meaning of the words "there are no other circumstances indicating to which debt the payment is to be applied", is well explained if we take an illustration.

ILLUSTRATION

A owes to *B* three debts, say, of £ 20.15, £ 10.82 and £ 29.82, and sends *B* a cheque for £ 29.82. Here the nature of this amount and the circumstances would be taken as clearly indicating that the payment is meant to be appropriated towards the third debt even though *A* does not expressly state that.

If, however, there is a *current account* between the parties and neither party makes any appropriation, the payment shall be applied in discharge of the debts in order of time, irrespective of any bar under the Limitation Act.

If the debts are of *equal standing* the payment shall be applied in discharge of each proportionately.

Where neither party makes any appropriation, the payment is to be applied in discharge of the debts *in order of time* whether or not they are time-barred. If the debts are of equal standing the payment is to be applied in discharge of each proportionately (S. 61). In *England*, according to the rule in *Clayton's Case*, the law appropriates it to the earliest debt which is not statute-barred.

⁹ *Bitari Ram v. Kanji Singh* (1915), 19 Cal. W.N. 237

¹⁰ *Rama Shah v. Lal Chand* (1940), 67 I.A. 160, *Cory Bros. & Co. v. The Mecca* (1897), A.C. 286

¹¹ *Malik v. Rahim*. A.I.R. (1922), Pat. 369

This rule is known as the *Rule in Clayton's Case* [(1816), 1 Mer. 572]. It is applied generally in cases where there is a current account between the parties, e.g., between a banker and his customer. In Clayton's case Clayton had an account in a firm. When one of the partners of the firm died, the amount due was £ 1,717. Later the surviving partners paid out to Clayton more than this amount and Clayton himself deposited further amounts in the account. When the firm was subsequently adjudged bankrupt, the Court held that the estate of the deceased partner was not liable to Clayton as the amount due to Clayton at the time of the death of that partner had been completely discharged. Thus according to the *rule in Clayton's case* when the creditor makes no appropriation and there is a current or running account between the parties, debits and credits must be set off against one another in order of their dates and the final balance to be recovered.

An exception to the *rule in Clayton's case* is known as the *Rule in Hallett's Estate*. It applies only when a trustee mixes up his own money with trust money in a running account.

ILLUSTRATION

A trustee deposits Rs 2,000 belonging to a trust in a bank account and deposits Rs 3,000 of his own in the same account. Subsequently he withdraws Rs 2,000 from the bank and uses it for his own affairs. The withdrawal of Rs 2,000 will not be debited against the first deposit of trust money but unlike the *rule in Clayton's case* it will be considered to be a withdrawal of the trustee's own money though that deposit was made later.

(3) BY BREACH

Section 39 says, "when a party to a contract has *refused* to perform or has *disabled* himself from performing his promise in its *entirety*, the *other party* may put an end to the contract *unless* he has signified by words or conduct his *acquiescence* in its continuance." From this it follows that if one of the parties breaks the contract, the other party, if he has not acquiesced in it, may, as his option, declare the whole contract to be at an end. The section gives an illustration of a singer who agreed to sing for eight nights in a theatre. She sang for the first five nights but on the sixth she wilfully absented herself. Here the theatre manager has the option to put an end to the contract altogether. But if he allows her to sing again on the seventh night he will have acquiesced in the continuance of the contract, with the result that though he cannot claim to put an end to

the contract he can still insist upon being compensated for the damage sustained by him.

The breach of a contract may be in one of the following ways—

(1) By *renunciation* of liability by one of the parties before the time of performance. Here the renunciation must refer to the whole as contract.

(2) By one of the parties through his own *conduct* making it *impossible* to perform a contract, e.g. when a man who has agreed to sell or deliver his horse, sells and delivers it to a third party before the delivery day prescribed by the previous contract.

(3) Where one of the parties has *partly performed* his part, and the opposite *party refuses to allow* him a complete performance; e.g. where *A* agreed to sell and deliver to *B* 50 tons of coal and actually delivered 20 tons, after which *B* refused to take any more coal. Here *A* is discharged from delivering a further 30 tons and also acquires a right to sue *B* for compensation for the breach.

(4) When one of the parties *fails entirely to perform* his part.

With regard to the *renunciation* or repudiation of the contract it must be an absolute and clear refusal to perform and abide by the whole contract and must be accepted by the other side. When, therefore,¹² *R* agreed to supply *W* with straw to be delivered at *W*'s premises in a certain quantity every fortnight during a specified time and *W* agreed to "pay Rs 33 per load for each load of straw so delivered", and after the straw had been delivered for some time *W* refused to pay for the last load delivered, insisting that he would keep one payment in arrear, it was held that as here according to the agreement each load had to be paid for on delivery, the refusal of *W* to do so in future was a breach. It must, however, be noted that here there was an actual refusal to pay. If, however, there was only a failure to pay one out of a series of payments that will not amount to a repudiation of the contract. Again, to bring the case within this rule, the repudiation should have been accepted by the other side; e.g. in one case it was agreed between *A* and *B* that *A*'s ship should go to Odessa and there load a cargo. In Odessa *B*'s agent failed to offer cargo, saying he had none to load. The captain of the ship as *A*'s agent refused to take this refusal and insisted upon the cargo being loaded. In the meantime war broke out between England and Russia and *B* took up the defence that the contract was dissolved. It was held that as the refusal was not taken there was no breach or

¹² In *Withers v. Reynolds* (1831), 1 L.J.K.B. 30

renunciation and therefore *B*'s defence was held good.¹³ This is because where there is an *anticipatory breach*, i.e. one party renounces before the time for performance, it gives the other party an immediate right of action. If he does not act at once, any subsequent risk will fall on him. Anticipatory breach is dealt with in greater detail in the chapter on the sale of goods.

'Quantum Meruit'

With regard to part performance of a contract, it will be interesting to take up the effect of the maxim which lays down the law relating to the rights of the party who has performed a part of his obligation, to sue and recover for the actual work done *quantum meruit* (according to merit). Whether a person can sue or recover a *quantum meruit* depends upon the nature of the contract.

If the work is an entire work for a specified sum, e.g. to build or to serve for a fixed period and the entire work is not carried out, there would be a breach which would excuse the other side, and the party who fails to carry out the work cannot sue with a view to recover the value of the actual work done, e.g. if a builder abandons an *entire* contract to erect a building after erecting a portion of it, he cannot recover anything on account of the finished work even though the owner of the building takes up the work done and finishes it from the point left off by the contractor. This is because here the performance of the whole work is the essence of the contract. Even in the case of an entire contract, a *quantum meruit* may be claimed if it has been previously agreed or if the completion of the work has been prevented by the fault of the other party.

If, however, the contract is of a *divisible* nature, e.g. supply of 100 bales of cotton at Rs 500 per bale, the person who has performed a portion of the duty on such a contract by supplying 25 bales and failing to supply the rest, may sue on the *quantum meruit* of the actual bales delivered. The origin and nature of this remedy will be discussed later in this chapter.

Anticipatory Breach

When a party to a contract refuses to perform or disables himself from performing his obligation *before* the due date of performance, the other party need not wait till the due date but may instead treat the contract as broken and sue for damages for non-performance. In

¹³ *Avery v. Bowden* (1816) 5 E, and B. 714

*Hochster v. Delatour*¹⁴, A engaged B on 12th April as courier to accompany him on a tour. The employment was to commence on 1st June. Before that date, on 11th May, A wrote to B informing him that A would not require his services. B sued A immediately for a breach of contract without waiting for 1st June, the day fixed for performance. It was held that B was not bound to wait till the due date of performance but could take action immediately.

(4) BY LAPSE OF TIME

Although under the Limitation Act the efflux of time does not actually terminate the contract, it, in effect, in depriving the party of his remedy at law to enforce brings about the same result. The period of limitation is three years in ordinary contracts (in *England* it is six years and twelve years for *speciality* contracts).

(5) BY IMPOSSIBILITY

Section 56 of the Indian Contract Act clearly lays down that if a contract which was possible of performance becomes subsequently impossible by reason of some event which the promisor could not prevent, or becomes unlawful, the contract immediately becomes void. This is also known *frustration* of the contract brought about by *supervening impossibility*. This has already been dealt with in a previous chapter.¹⁵

(6) BY OPERATION OF LAW

Contracts here may terminate under three circumstances. (1) By *Merger*, i.e. where a party or parties embody an inferior contract in a higher contract, e.g. where a judgement has been given in an action for debt or breach of contract and a decree obtained, the original right becomes merged in the higher right under the Court's decree and no subsequent action can lie between the same parties for the same cause of action.

(2) In *Insolvency*, i.e. where the Insolvency Commissioner passes an order to discharge the insolvent, which order exonerates or discharges him from liabilities on all debts incurred previous to his adjudication.

¹⁴ (1853) 2 E. and B. 678

¹⁵ Please see Chapter 9

(3) By an unauthorized *alteration* or *loss* of a written document.

REMEDIES FOR BREACH OF CONTRACT

DAMAGES

When a contract has been broken, the party who suffers such a breach is entitled to receive from the party who has broken the contract compensation for any loss or damage caused to him thereby. If he can prove substantial loss, he will get substantial damages—otherwise he will only get nominal damages. Such compensation, however, is not to be given for any remote and indirect loss or damage sustained by reason of the breach (S. 73).

Measure of Damages

The measure of damages, normally, in case of breach of contract for sale of goods, is the difference between the contract price and the market price on the date of breach. It is, however, open to the parties to the contract to create for themselves any special rights and objections that they may please, such as providing their measure of damages in case of breach of contract and specially excluding the conditions which law generally attaches to a contract of sale of goods. In fact S. 62 of the Sale of Goods Act is a statutory recognition of this right in the parties.¹⁶

Classification of Damages

Damages may be divided into three classes—

- (1) General Damages;
- (2) Special Damages; and
- (3) Exemplary or Vindictive Damages.

1. General Damages

General damages are implied by law and are, therefore, always recoverable on a breach of contract: whereas special damages are only recoverable when they are either specifically provided for or where the other side was aware of their probability. According to the rule in *Hadley v. Baxendale*¹⁷, when a plaintiff proves that the breach of contract has caused him actual loss, he is only entitled to those damages which (a) *naturally arose* in the usual course of events arising from such a breach, and which (b) *both the parties knew to be likely* to result from the breach at the time they made the contract. Damages which do not fall within the rule of *Hadley v. Baxendale*, are said to be too *remote*.

¹⁶ *Union of India v. T. D. L. Patel*, A. I. R. 1971 Del. 120

¹⁷ (1854) 9 Ex. 341

As damages are compensatory and not penal in estimating such damages the means which existed of remedying the inconvenience and mitigating the extent of the loss must be taken into account.

ILLUSTRATIONS

(i) *A* hires *B*'s ship to go to Bombay, and there to take on board, on the 1st of January, a cargo which *A* is to provide and bring to Calcutta, the freight to be paid when earned. *B*'s ship does not go to Bombay but *A* has opportunities of procuring suitable conveyance for the cargo upon terms as advantageous as those on which he had chartered the ship. *A* avails himself of those opportunities, but is put to trouble and expense in doing so. *A* is entitled to receive compensation from *B* in respect of such trouble and expense.

(ii) Where a contractor rescinded his contract with the Government to collect Lac, the Court held that Government should have reauctioned the contract and that the contractor was entitled to get the benefit of Government's failure to reauction.¹⁸

(iii) *A* agreed to sell *B* 5 bales of Broach cotton at, say, Rs 900 per bale, the delivery to be given on 15th January, 1917. *A* fails to give delivery. The remedy of *B* would be to claim the difference between the market price and the contract price for the same quality of cotton in case the market price is higher than the contract price.¹⁹

Market price means a price charged to an ordinary customer and the fact that one of the parties could have obtained goods through some particular arrangement at a lower price is no argument. If there is no market rate for the subject-matter of the contract the value must be taken on the basis of the price which has to be paid for the nearest substitute. Failing any substitute being there, the market price will be ascertained by adding to the price at the place of purchase the expenses of getting them to the place of purchase plus the usual profit of the importer.²⁰ If the buyer waits after the time of delivery at the urgent request of the seller to give time and then fails to deliver and in the meantime the market rises, the damages would have to be paid on the scale of the higher price.²¹ If, on the other hand, the goods were to be shipped or forwarded to some other place, the damages would be computed on the basis of the price procurable in that place minus the cost of transit.

¹⁸ *Ramalal v. State of Madhya Pradesh*, A.I.R. 1963 Madh: Pra. 242

¹⁹ *William Bros. v. Ed. T. Agins Ltd.* (1914) Ap. Cas. 510

²⁰ *Haji Ismail & Sons v. Wilson & Co.*, 41 Mad. 709

²¹ *Ogle v. Earlaue*, L.R. 3 Q. B. Cal. 272

2. *Special Damages*

Special damages arise under *special circumstances* where the party to the contract has made a specially advantageous bargain through which he expects to make specially large profits which profits are likely to be lost through the breach of the contract. Special damages are *only recoverable if* (a) the special circumstances were *known* to both the parties at the time of making the contract, and (b) the damages are such as *would naturally result* from the breach of a contract so made.

ILLUSTRATION

A has entered into an advantageous contract, say, to supply iron rails to a Railway Company, which he covers by a contract with an Iron Company. These rails are to be delivered at dates specifically stipulated. A expects to make a large profit on the difference. The Iron Company fails to keep the contract (and thus the Railway Company rescinds its contract) with A. The price at which A was to supply these rails to the Railway Company was much higher than the market rate on the date of delivery. In this case A can recover only the difference on the basis of the market price from the Iron Company unless A had made it clear to his seller (Iron Company) that the breach of contract by them would involve him in a special loss through his failure to keep the advantageous contract. Thus what is required here is that the special circumstances under which the party expects to make a special loss through the breach of contract by the other side must be communicated if special damages are to be recovered. Here also it must be noted that if A could have bought those rails in the market in sufficient quantity to meet his buyer, the Railway Company, he should have done that in order to mitigate the damages, because "a person with whom a contract has been broken has a right to fulfil that contract for himself as nearly as may be, but he must not do this unreasonably or oppressively as regards the other party, or extravagantly".

3. *Exemplary or Vindictive Damages*

Exemplary damages are specially *penal and heavy* damages awarded by courts in cases such as a breach of promise to marry where the injured feelings of the party aggrieved are also taken into account and in actions against bankers for refusing to honour a customer's cheque when they have funds of his to meet it. Exemplary damages are not recoverable in the case of the breach of mercantile contracts because the main object of law here is to compensate the party aggrieved and not to punish the other side.

Liquidated Damages and Penalties

The parties to a contract may mention in the agreement a certain sum to be paid to the injured party on breach of the contract. Such a sum may be *liquidated damages*, i.e. a genuine pre-estimate of the

damage which the parties believe likely to be caused if the contract is broken, or it may be by way of *penalty*, i.e. when the sum is fixed in order to prevent or penalise a breach. The actual words used by the parties in naming the sum, are immaterial and the court will consider the real intention of the parties and will allow the injured party the full sum named only if it finds that the sum is by way of liquidated damages and not by way of penalty. Thus the court is not bound by such a figure which may be mentioned and may allow a lesser amount but will never allow a larger amount than that so fixed.

Section 74 of the *Indian Contract Act* clearly lays down in this connection that "When a contract has been broken, if a sum is named in the contract as the amount to be paid in case of such breach, or if the contract contains any other stipulation by way of penalty, the party complaining of the breach is entitled whether or not actual damage or loss is proved to have been caused thereby, to receive from the party who has broken the contract reasonable compensation not exceeding the amount so named, or as the case may be, the penalty stipulated for". It further explains that "A stipulation for increased interest from the date of default may be a stipulation by way of penalty".

ILLUSTRATION

A contracts with B to pay B Rs 1,000 if he fails to pay B Rs 500 on a given day. A fails to pay B Rs 500 on that day. B is entitled to recover from A such compensation, not exceeding Rs 1,000, as the court considers reasonable.

The *exception* to the section provides for the recovery of the whole amount in the case of a bailbond, a recognizance or any bond for a performance of a public duty given under the provisions of any law or by the orders of the Government.

QUANTUM MERUIT

The principle of *quantum meruit* is rooted in English Law under which there were certain procedural advantages in framing an action for compensation for work done. The original contract must have been terminated by the defendant in such a way as to entitle the plaintiff to regard himself as discharged from any further performance and he must have elected to do so. The remedy, however, is not available to the party who breaks the contract even though he may have partially performed part of his obligation. This remedy by way of *quantum meruit* is restitutory i.e., it is a recompense for the value of the work done by the plaintiff in order to restore him to the

position which he would have been in, if the contract had never been entered into. Thus it is different from a claim for damages which is a compensatory remedy aimed at placing the injured party as near as may be in the position which he would have been in, had the other party performed the contract. "*Compensation quantum meruit*" is awarded for work done or services rendered when the price thereof is not fixed by a contract. For work done or services rendered pursuant to the terms of a contract. For work done or services rendered pursuant to the terms of a contract *compensation quantum meruit* cannot be awarded where the contract provides for consideration payable in that behalf. Where work is done under a contract pursuant to the terms thereof no amount can be claimed by way of *quantum meruit*.

SPECIFIC PERFORMANCE

When one party commits a breach of contract the other party is entitled to bring a suit for damages, *i.e.* for compensation in money. In certain cases however, the Court has the discretion to order actual performance of the contract. This is known as specific performance. "*Specific performance* is equitable relief given by the Court in cases of breach of contract, in the form of a judgment that the defendant do actually perform the contract according to its terms and stipulation".²²

ILLUSTRATION

In this connection the Supreme Court has held that Section 74 which has done away with the common law distinction between liquidated damages and penalty applies not only to cases where the aggrieved party is seeking to receive some amount on breach of contract but also to cases upon breach of contract an amount received under the contract is sought to be forfeited. In all cases therefore where there is a stipulation in the nature of penalty for forfeiture of an amount deposited pursuant to the terms of contract which expressly provides for forfeiture, the Court has jurisdiction to award such sum only as it considers reasonable, but not exceeding the amount specified in the contract as liable to forfeiture. In that case the stipulation was for payment of Rs 1,000 as earnest on execution of the document and Rs 24,000 "out of the sale price" against delivery of possession, the entire sum of Rs 25,000 to be forfeited and the agreement cancelled if the purchaser failed to register the sale-deed by a stated date. On failure to complete the sale each party blamed the other and the amount of Rs 25,000 was sought to be forfeited. As there was no evidence to show that the plaintiff was allowed to retain Rs 1,000 which was the earnest money as part of the damages but not the remaining sum of Rs 24,000.²³

²² Halsbury, *Law of England*

²³ *Fateh Chand v. Balkishan Das*, A. I. R. 1963 Supreme Court 1405

In India the Specific Relief Act, 1963 codifies the English Law on the subject with a few modifications.

In the following cases contracts *may be specifically enforced*:—

- (1) To enforce a trust.
- (2) When there is no standard for ascertaining the actual damage caused by the non-performance of the act agreed to be done, *e.g.* an agreement to sell a picture by a dead artist of a rare china vase.
- (3) When damages would not afford adequate relief, *e.g.* a contract to sell a particular plot of land. Here the peculiar and special advantage by reason of its position or quality cannot be compensated sufficiently by mere monetary relief by way of damages.
- (4) When compensation in money cannot be obtained *e.g.* in cases of contracts for personal acts such as to settle boundaries on neighbouring estates, to renew a lease, to endorse a bill etc.

The following contracts *cannot be specifically enforced*:-

- (1) Where mere payment of money(*i.e.* pecuniary compensation) is adequate relief.
- (2) Contracts running into minute or numerous details.
- (3) Contracts depending on personal qualifications.
- (4) Where the nature of the contract prevents it from being specifically enforced.
- (5) Where the terms are uncertain.
- (6) A contract by a trustee in excess or in breach of his trusts.
- (7) *Ultra vires* contracts by corporations or public companies or their promoters.
- (8) A contract involving the performance of a continuous duty which the court cannot supervise.
- (9) Where a material part of the subject-matter has ceased to exist before the date of the contract.
- (10) Contracts by minors.

The remedy of specific relief unlike that of damages cannot be obtained as a matter of right but rests entirely on the discretion of the Court. As this is an equitable remedy, the plaintiff, *i.e.* the person who claims the relief, must show that he himself has performed or is ready and willing to perform his part of the agreement. This rule is based on the maxim, "He who seeks equity must do equity".

INJUNCTION

An injunction is preventive relief. It is an order of the Court to the other party to refrain from doing something which that other party is under an obligation not to do. This remedy is also entirely in the *discretion* of the Court and cannot be claimed as of right. An injunction may be (a) temporary or (b) perpetual.

A *temporary injunction* is granted provisionally until a specified time or until the further order of the court. Its object is only to preserve the property in dispute until the final disposal of the case and may be granted at any stage of a suit.

A *perpetual injunction* is of a permanent nature and can only be granted by a decree of the Court when a right is established.

As regards contracts the Court has power to grant injunction where the contract is specifically enforceable.

PAYMENT OF INTEREST

1. In case of Default

If the agreement provides for the payment of interest in case of default the Court will permit the payment if the interest is reasonable but not if it is exorbitant.

2. At a Higher Rate

If the agreement provides for payment of interest at a particular rate and on default at a higher rate, it depends on whether the higher rate is to be paid:

- (a) from the date of bond, or
- (b) from the date of default.

If the higher rate is to be paid *from the date of the bond* and not from the date of default it would be in the nature of a penalty and the court will grant relief. If, however, the higher rate of interest is to be paid *from the date of the default* it will be a question of construction whether it is in the nature of a penalty.

3. Compound Interest

If the payment of compound interest on default of payment of simple interest is *at the same rate* as simple interest no relief will be granted as the Court will not consider it in the nature of a penalty but if the rate of compound interest is at a rate *higher than simple interest* it will be regarded as penal and the Court will grant relief.

SUMMARY

Termination or Discharge of Contracts

A contract is brought to an end in any of the following ways

1. By Agreement or Consent

- (a) *Accord and Satisfaction*
- (b) *Novation i.e.*, substitution of a new contract for an existing one.
- (c) *Waiver i.e.* voluntarily giving up a right by a party to the contract.
- (d) *Remission i.e.* acceptance of less than what a party to the contract is entitled from the other party.
- (e) *Rescission i.e.* Cancellation
- (f) *Alteration (Authorised).*

2. By Fulfilment of Performance

- (a) Actual or
- (c) Constructive *i.e.* by tender

3. By Breach

- (a) Actual or
- (b) Anticipatory *i.e.* before the due date of performance.

4. By Lapse of Time

i.e. failure to sue within the period of limitation.

5. By Impossibility

- (a) Physical or legal
- (b) Initial or Subsequent (Frustration)

6. By Operation of Law

- (a) Death
- (b) Insolvency
- (c) Merger
- (d) Alteration (Unauthorised)

Appropriation of Payments

1. There must be distinct debts.
2. The debtor and the creditor in respect of the debts must be the same.
3. The payment made by the debtor must be insufficient to discharge all the debts.
4. The debtor has the right of appropriation to any of the debts. This he may do expressly *i.e.* by words spoken or written indicating the particular debt, or impliedly *i.e.* by sending the exact amount of a particular debt.
5. If the debtor does not exercise his right of appropriation,

the creditor may appropriate the amount sent to any debt, including a time-barred debt.

6. If neither debtor nor the creditor has appropriated the amount to any particular debt the court will make the appropriation, in order of time. This is known as the Rule in Clayton's case. If all the debts are of equal standing, amount sent will be applied to the discharge of each of the debts proportionately.

Remedies for Breach of Contract

1. Damages
 - (a) General Damages
Rule in Hadley v. Baxendale
 - (b) Special Damages
 - (c) Exemplary or Vindictive Damages
2. Specific Performance
3. Injunction
4. Interest
 - (a) In case of default
 - (b) At a higher rate
 - (c) Compound interest

Difference between liquidated damages and penalty.

Assignment of Contracts

Actionable Claims

TYPICAL QUESTIONS

1. (a) What do you understand by 'novation'?
- (b) What are the rules laid down by the Indian Contract Act with regard to assessment of damages on a breach of contract?
2. (a) When is a contract discharged?
- (b) What are the remedies for breach of a contract?
3. (a) Explain the doctrine of 'accord and satisfaction' and how far is it applicable under Indian Law?
- (b) What are the remedies available for breach of contract?
4. What are the rules under the Contract Act as to the appropriation of payments?
5. What is Novation?

X says to *Y*, "Give *Z* a receipt in full for the debt which he owes you and I will pay you the amount." *Y* agrees. Discuss what kind of contract this is.

6. *A* owes *B* two debts of Rs 4,750 and Rs 327.50. *B* telephones to *A* saying that he badly needs Rs 300 immediately, and that *A* should therefore repay at once at least the debt of Rs 327.50. *A* merely sends *B* a cheque for Rs 327.50. *B* then finds that the other debt of Rs 4,750 is about to get time-barred, and applies the cheque in part payment of that debt. Discuss.

7. What is meant by suing on quantum meruit?

8. What is meant by "frustration" of a contract and what is its legal result?

On 1st July, *A* the owner of a hall, agrees with *B* that the latter shall be allowed to use the hall for one week, commencing 22nd July in order that *B* may exhibit pictures painted by him. On 10th July the hall is completely destroyed by fire. *B* claims damages for breach of contract. *A* cannot prove that the fire was not due to his default or default of any one for whose act or default he is responsible. Advise *A* as to his position.

9. Write short notes on the following —

(a) Rules of Appropriation (*Clayton's case*).

(b) Penalty and Liquidated damages.

10. 'Damages never do more than restore the injured to the position he would have been had the promisor performed his promise'. Explain and illustrate.

11. *A* was due to perform a contract on March, 1970 but on 25th February repudiated his obligation. On 28th February the contract became illegal through a change in the law. *B*, the other party to the contract, filed a suit for breach of contract on 1st March, 1970. Discuss.

12. Explain briefly—

(a) Exemplary damages

(b) specific performance

13. (a) Discuss the principle underlying novation.

(b) *A* contracts to take in cargo for *B* at a foreign port. *A*'s Govt. afterwards declares war against the country in which the port is situated. Discuss the rights of the parties.

14. Explain "anticipatory breach of contract" and discuss the consequences of such breach on the rights and liabilities of the parties.

15. Write short notes of the following—

1. Essential conditions of a valid tender.

2. Rules governing appropriation of payment of debts.

3. What is anticipatory breach of contract?

Discuss in particular the rights of the party aggrieved by the breach.

Chapter 12

CONTRACTS

Indemnity and Guarantee

CONTRACTS of indemnity and guarantee are special types of contracts and are dealt with in Sections 124 to 127 of the Indian Contract Act. As they form a part of the general law of contracts, in order to be valid a contract of indemnity or guarantee must have *all the essentials of a valid agreement* such as consideration, free consent, competency of parties, legality of object, certainty and possibility of performance, etc.

CONTRACT OF INDEMNITY

Definition

A contract of indemnity is defined by the Indian Contract Act as a contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person (S. 124).

ILLUSTRATION

If *A* undertakes to indemnify *B* against the consequences of any proceedings which *C* may take against *B* in respect of a certain sum of Rs 200, the contract will be a contract of indemnity, *A* being the indemnifier and *B* the indemnity-holder.

Thus in an indemnity contract there are two parties, the party who promises to save the other from loss and the promisee. For example, when shares are transferred, the transferee is bound to indemnify the transferor against future calls.

A contract of indemnity may be *express* or *implied*.

Commencement and Extent of Indemnifier's Liability

As to when the indemnifier's liability commences and the extent of his liability, is not clearly laid down by our Act, but the English decisions and authorities are followed by our Indian Courts and it has been held that the right to claim to be indemnified arises *as soon as the indemnity holder has incurred* the liability. It is not necessary that he should have made the payment. This is because if payment by the indemnity holder is to be a condition precedent to recovery from the indemnifier, the contract of indemnity may be of no value to an indemnity holder who is unable to make the payment in the first instance.¹

Indemnity is thus defined in *Halsbury's Laws of England*: "An indemnity is a contract expressed or implied, to keep a person, who has entered into, or who is about to enter into, a contract or incur any liability, indemnified against loss, independently of the question whether a third person makes a default".

It will thus be seen that indemnity in *English Law* has a much wider meaning, because there the loss would have to be paid independently of the question whether a third, or, as a matter of fact, any person has made a default.

Promisee in Indemnity Contracts

When an indemnity holder is sued in relation to the matter against which he was indemnified, and a judgment is given against him, the judgment will be conclusive because of the contract of indemnity although the indemnifier was not a party to it.² This rule of *English law* is followed by our Courts and as soon as a decree is passed against him, the indemnified, *i.e.*, the promisee in an indemnity contract is entitled to claim from the indemnifier.³

Section 125 thus provides that the promisee in a contract of indemnity, acting within the scope of his authority, *is entitled to recover from the promisor*:

¹ *Osman Jamal & Sons Ltd. v. Gopal Purshottam* (1928), 56 Cal. 262, 118 I.C. 228

² *Parker v. Lewis* (1873) L.R. 8 Ch. 1035.

³ *Chiranjil Lal v. Naraini* (1919) 41 All. 295.

(1) all damages which he may be compelled to pay in any suit in respect of any matter to which the promisee to indemnify applies;

(2) all costs which he may be compelled to pay in any such suit if, in bringing or defending it, he did not contravene the orders of the promisor, and acted as it would have been prudent for him to act in the absence of any contract of indemnity, or if the promisor authorized him to bring or defend the suit;

(3) all sums which he may have paid under the terms of any compromise of any such suit, if the compromise was not contrary to the orders of the promisor, and was one which it would have been prudent for the promisee to make in the absence of any contract of indemnity, or if the promisor authorized him to compromise the suit.

Under this section the person who is indemnified against losses and damages may not only recover the losses and damages that he may have to pay, but he is also entitled to recover the costs of defending any suit that may be brought against him, in connection with this contract of indemnity, provided, of course, that he does not defend this suit contrary to the orders of the promisor and that in conducting the suit he acts as a reasonable and prudent man would have acted in his own case. Again, if the promisee compromises the suit with the authority of the promisor, he would be entitled to recover the amount paid towards the compromise from the promisor. If he acted without consulting the promisor, even then the amount paid as compensation was not contrary to the orders of the promisor and was one which it would have been prudent for the promisee to make if there was no contract of indemnity.

The Indian Contract Act does not mention the rights of a *promisor* in a contract of indemnity but the rights of a promisor under *English Law* will apply. These are similar to the rights of a surety as mentioned in Section 141.

CONTRACT OF GUARANTEE

Definition

A contract of guarantee, on the other hand, is *defined* by section 126 of the Contract Act as “a contract to perform the promise, or discharge the liability, of a third person in case of his default. The person who gives the guarantee is called the ‘*surety*’; the person

in respect of whose default the guarantee is given is called the 'principal debtor' and the person to whom the guarantee is given is called the 'creditor'. Thus in a contract of guarantee there are three parties, viz. (1) the surety, (2) the principal debtor, and (3) the creditor. In *Indian Law* "a guarantee may be either oral or written". Thus where A guarantees to B that if he lends Rs 3,000 to C, C shall pay the amount within the stipulated time in accordance with his agreement, failing which A shall make good that amount, or in case of an ordinary agreement of sale of goods if A guarantees B that if he gives credit to C in connection with the goods he sells to C for a particular duration, C shall pay the cost of the goods B sells to him, failing which he (A) shall be responsible to make good the amount due either in full or upto a certain limit, it is a contract of guarantee. In *English Law* a guarantee is defined as "a promise made by one person to another to be collaterally answerable for the debt, default or miscarriage of a third person" and is required to be evidenced by writing under the Statute of Frauds, while a contract of indemnity is not.

Difference between Indemnity and Guarantee

There are three main points of difference between an indemnity and a guarantee. They are—

(1) In an indemnity contract there are only two parties, whereas in a guarantee there are three:

(2) In an indemnity contract the indemnifier of the promisor, is primarily liable and there is no secondary liability whereas in a guarantee the surety is only collaterally liable, the primary liability being on the principal debtor; and

(3) In an indemnity contract, the indemnifier has some interest in the transaction apart from his promise to pay the loss but the guarantor or surety's only interest in the contract is his promise to pay the loss.

It will be seen, therefore, that in the case of a guarantee the primary responsibility lies on the principal debtor and the surety's obligation depends substantially on the default of the principal debtor. If there was no principal debtor, or if the principal debtor was there but the surety took upon himself the primary responsibility of paying the debt, it will come under the heading of indemnity and not of guarantee. Our section also makes contracts of guarantee binding even when they are oral, whereas, in *England*, under the Statute of Frauds, *contracts of guarantee must be evidenced by a*

memorandum or note in writing. It may be added here that it is necessary that these contracts should be supported by consideration like all other simple contracts and all rules of evidence will apply to them. It will be considered a sufficient consideration if anything is done or promised by the creditor for the benefit of the principal debtor, surety or any other person.

ILLUSTRATIONS

(a) *B* requests *A* to sell and deliver to him goods on credit. *A* agrees to do so, provided *C* will guarantee the payment of the price of goods. *C* promises to guarantee the payment in consideration of *A*'s promise to deliver the goods. This is sufficient consideration for *C*'s promise.

(b) *A* sells and delivers goods to *B*, *C* afterwards requests *A* to forbear to sue *B* for the debt for a year, and promises that if he does so, *C* will pay for them in default of payment by *B*. *A* agrees to forbear as requested. This is a sufficient consideration for *C*'s promise.

(c) *A* sells and delivers goods to *B*, *C* afterwards, without consideration, agree to pay for them in default of *B*. The agreement is void (ills. to S. 127).

The guarantor is "collaterally liable" and therefore if he pays, the principal debtor is not released from his liability but the guarantor steps into the shoes of the creditor.

Liability of the Surety in Guarantee Contracts

The liability of the surety is co-extensive with that of the principal debtor, unless the contrary is provided for. For example, if *A* guarantees the payment of a bill of exchange by *C*, the acceptor and the bill is not paid, *A* would not only have to pay the amount of the bill but also any interest and charges that may have become due on it (S. 128).

Only in the case of *default by the principal debtor*, can the creditor proceed against the surety immediately and is not bound to sue the principal debtor in the first instance unless the guarantee lays down that specifically. The creditor cannot be precluded from taking this action even on the ground that he holds securities belonging to the debtor.

If the agreement between the principal debtor and the creditor is void, the surety is not bound. For example, *B* guaranteed an infant's overdraft at his bank. Under the Infant's Relief Act, the infant's debt to the bank is void. It was therefore held that *B* was not liable.⁴

Where a guarantee is given for running balance of account, say by *A* to *B*, not exceeding Rs 1,000 with respect to debts contracted between *B* and *C* and supposing that *C* becomes insolvent and the debt owing to *B* is Rs 1,500 on which a dividend of 50 Paise a rupee is paid, say in all Rs 750, *A* can be called upon to pay the balance of Rs 250 only. Here it has been clearly laid down that the creditor *B* cannot claim from *A* his whole loss of Rs 750 in this case as the guarantee was for Rs 1,000. Of course, by a special agreement his position may be altered but in that case the condition that such a rule was not to apply ought to be clearly expressed.⁵ Thus where *X* guarantees to the landlord *Y* that *Z* the tenant will pay the rent and if he fails to do so *X* will be liable to pay up the amount, *X* is only liable to pay the rent and not interest thereon, unless the guarantee agreement itself expressly stipulates that *X*'s liability will include the interest on such rent if *Z* the tenant fails to pay.⁶ However, if *Y* the landlord has obtained a decree against *Z* for non-payment of rent, *Y* cannot enforce that decree against *X* the guarantor, but he must in a separate suit prove the liability of the guarantor, or surety, viz. *X* unless it is provided in the contract of guarantee that a judgment or award against the tenant or principal debtor will be binding or admissible against the surety.⁷

Specific and continuing Guarantee

A *specific guarantee* is a promise to be collaterally answerable for one single transaction only or which comes to an end on repayment of the advance for which it was given.

A guarantee is a *continuing guarantee* when it extends to a series of transactions (S.129).

ILLUSTRATIONS

(a) where *A* in consideration that *B* will employ *C* in collecting the rents or *B*'s estate, promises *B* to be responsible to the amount of Rs 5,000 for the due collection and payment by *C* of those rents, it is a continuing guarantee;

(b) *A* guarantees payment to *B*, a tea-dealer, to the amount of £ 100, for any tea he may from time to time supply to *C*. *B* supplies *C* with tea to the above value of £ 100, and *C* pays *B* for it. Afterwards *B* supplies *C* with tea to the value of £ 200. *C* fails to pay. The guarantee given by *A* was a continuing guarantee and he is accordingly liable to *B* to the extent of £ 100.

(c) *A* guarantees payment to *B* of the price of five sacks of flour to be delivered by *B* to *C* and to be paid for in a month. *B* delivers five sacks to *C*, *C* pays for

⁵ *Bardwell v. Lydall* (1831), 7 Bing. 189; *Hobson v. Bass* (1871), L.R. 6 Ch 729-941

⁶ *Maharaja of Benares v. Harnarain Singh* (1906), 28 All. 25

⁷ *Hajarimal v. Krishnarav* (1881), 5 Bom. 647

them. Afterwards *B* deliver four sacks to *C*, which *C* does not pay for. The guarantee given by *A* was not a continuing guarantee, and accordingly he is not liable for the price of the four sacks (ills. to S. 129).

It should be noted that if a person guarantees the repayment by another of a certain sum by regular instalments within a specified time, it is not a *continuing guarantee*, because here a single transaction, namely, a loan is guaranteed. Similarly when a person guarantees the faithful discharge of the duties of a cashier by a person who is appointed to that position it is not a continuing guarantee.

A *continuing guarantee* may at any time be *revoked* by the surety, as to *future transactions*, by notice to the creditor, (S. 130).

ILLUSTRATIONS

(a) *A*, in consideration of *B*'s discounting, at *A*'s request bills of exchange for *C*, guarantees to *B*, for twelve months the due payment of all such bills to the extent of 5,000 rupees. *B* discounts bill for *C* to the extent of 2,000 rupees. Afterwards, at the end of the three months, *A* revokes the guarantee. This revocation discharges *A* from all liability to *B* for any subsequent discount. *A* is liable to *B* for the 2,000 rupees, on default of *C*.

(b) *A* guarantees to *B*, to the extent of 10,000 rupees, that *C* shall pay all the bills that *B* shall draw upon him. *B* draws upon *C*. *C* accepts the bill, *A* gives notice of revocation. *B* dishonours the bill at maturity. *A* is liable upon his guarantee (ills. to S. 130).

Of course, for all transactions entered into previous to the notice, the guarantee would be binding on the guarantor. Of course, this section applies to cases where a series of distinct and separate transactions are contemplated; the words "future transactions" seem to imply that if the continuing guarantee is given for an entire consideration it can be revoked during the continuation of the relationship which constitutes that consideration, unless a material change occurs in the situation, such as dishonesty of the person whose fidelity is guaranteed, in which case the surety may, if he likes ratify or revoke the guarantee contract.

Termination of Guarantee

The guarantee may be terminated by—

- (1) Revocation (S. 130).
- (2) Death of the surety (S. 131).
- (3) Variation of contract without consent of surety (S. 133).
- (4) Discharge by creditor of the principal debtor without consent of surety (S. 134).

(5) Compounding with principal debtor by creditor without consent of surety (S. 135).

In the second case it is not necessary that the creditor should have known of the death of the surety; and even where the creditor has entered into fresh transactions after the death of the surety without knowledge of such death, the rule will come into force and the surety's estate would not be responsible for such transactions entered into after death. Of course, this rule is subject to an agreement to the contrary. As to all debts incurred previous to his death, the surety will be liable. In *English Law* notice to the creditor of the surety's death is necessary to bring the liability of the surety to an end.

Section 132 lays down the rule applicable to cases where two person contract with a third person to undertake certain liabilities and also contract between themselves that one of them shall act as surety, whereas the other shall be personally liable for the whole debt to the creditor. As far as *the creditor* is concerned, such an agreement between these two persons will *not affect his position* and he can hold both of them responsible under the contract as principals. This holds good under this section *even though the creditor knew* of the existence of this arrangement between these two debtors at the time the contract was entered into by them with him, because the second agreement between the debtors by which one debtor makes himself responsible for the full amount and makes the other debtor's liabilities that of a surety will not bind the creditor who is not a party to it. This rule is opposed to the rule *in English Law* where the relation between these two debtors, *viz.*, that of the principal debtor and the surety will affect the consequences of the contract.

ILLUSTRATION

A and *B* give jointly and severally a promissory note to *C* and if *A* signs the note on the understanding that he signs as the surety of *B* and that *B* is the principal debtor who is to pay for the note, the fact of *C*, the creditor, knowing this will not affect *A*'s position *in India* and *A* will be bound to pay as the principal debtor and not as the surety for *B*.

Variation in the Terms of a Guarantee Contract

Any *variation made without the surety's consent* in the terms of the contract between the principal debtor and the creditor, *discharges the surety* as to transactions subsequent to the variation (S. 133).

This rule is wide and general whereas the rule in the *English Law* lays down clearly, that the sureties will not be discharged under the circumstances above mentioned, unless the alteration is of a particular nature which would prejudice the rights of the surety. *In India*, on the contrary, it appears that even if the alteration were to be of a nature which would be beneficial to the guarantor, it would entitle him to claim a discharge.

ILLUSTRATIONS

(a) *A* becomes surety to *C* for *B*'s conduct as a manager in *C*'s bank. Afterwards, *B* and *C* contract, without *A*'s consent, that *B*'s salary shall be raised, and that he shall become liable for one-fourth of the losses on overdrafts. *B* allows a customer to over-draw, and the bank loses a sum of money. *A* is discharged from his suretyship by the variance made without his consent, and is not liable to make good this loss.

(b) *A* guarantees *C* against the misconduct of *B* in an office to which *B* is appointed by *C* and of which the duties are defined by an Act of the Legislature. By a subsequent Act, the nature of the office is materially altered. Afterwards, *B* misconducts himself *A* is discharged by the change from future liability under his guarantee, though the misconduct of *B* is in respect of a duty not affected by the latter Act.

(c) *C* agrees to appoint *B* as his clerk to sell goods at a yearly salary, upon *A*'s becoming surety to *C* for *B*'s duly accounting for moneys received by him as such clerk. Afterwards, without *A*'s knowledge or consent, *C* and *B* agree that *B* should be paid by a commission on the goods sold by him and not by a fixed salary. *A* is not liable for the subsequent misconduct of *B*.

(d) *A* gives to *C* a continuing guarantee to the extent of 3,000 rupees for any oil supplied by *C* to *B* on credit. Afterwards *B* becomes embarrassed and, without the knowledge of *A*, *B* and *C* contract that *C* shall continue to supply *B* with oil for ready money, and that the payments shall be applied to the then existing debts between *B* and *C*. *A* is not liable on his guarantee for any goods supplied after this new arrangement.

(e) *C* contracts to lend *B* 5,000 rupees on the 1st of March. *A* guarantees repayment. *C* pays the 5,000 rupees to *B* on the 1st of January. *A* is discharged from his liability, as the contract has been varied inasmuch as *C* might sue *B* for the money before the 1st of March.

The *surety is discharged* by any contract between the creditor and the principal debtor, by which the principal debtor is released, or by any act or omission of the creditor, the legal consequence of which is the discharge of the principal debtor (S.134).

A gives a guarantee to *C* for goods to be supplied by *C* to *B*. *C* supplies the goods to *B*, and afterwards *B* becomes embarrassed and contracts with his creditors (including *C*) to assign to them his property in consideration of their releasing him from their

demands. Here *B* is released from his debt by the contract with *C*, and *A* is discharged from his suretyship.

This is because the surety is entitled in case he is called upon to pay to be placed in the position of the creditor, and to acquire all the rights which a creditor possesses against the debtor. If, therefore, the creditor by any act or omission the legal consequence of which is the discharge of the principal debtor, deprives the surety of that right which the surety is entitled to claim, the surety is released. Also, where the default of the principal debtor was brought about through the connivance of the creditor, or through gross negligence on the part of the creditor, the same rule will apply. In one case, where the creditor instituted a suit against the principal debtor as well as the surety on a contract and subsequently waived his claim against the principal debtor, it was held that the surety was also discharged from his liability. A discharge of the principal debtor in the insolvency court does not, of course, discharge the surety.

Failure to sue within the Period fixed by the Limitation Act

Formerly there was a conflict among some High Courts in India as to whether a creditor's failure to sue the principal debtor within the period of limitation discharged the surety.

According to the judgments of the High Courts of Madras, Bombay and Calcutta where the creditor fails to sue the principal debtor within the period fixed by the Limitation Act, the surety is not discharged. The High Court of Allahabad held differently but the English decisions are the same as those of the High Courts of Bombay, Madras and Calcutta. The Madras High Court argued that barring by limitation does not discharge the debtor from his obligation as far as the debt is concerned, whereas in England the ground on which the surety is not discharged is that the surety himself could have brought an action against the principal debtor before the expiration of the time limit.⁸ The Privy Council has since held that in such a case the *surety is not discharged* and the conflict may now be taken to be settled.⁹

Compounding with Principal Debtor, etc.

If the creditor arranges with the principal debtor without consulting the surety for composition or agrees to give time or

⁸ *Sanakana v. Virupakasha*, 7 Bom. 146; *Krishto Kishori Chowdhraïn v Radha Ramun Munshi*, 12 Cal. 330; *Subramania Aiyar v. Gopala Aiyar*, 33 Mad. 308, *Ranjit Singh v. Naubat*, 24 All. 504

⁹ *Mahant Singh v. U Ba Yi* (1939) 66 I.A. 198

agrees not to sue him, these acts will immediately discharge the surety (S.135). It is *held* that the creditor has no right in law to give time to his debtor without the consent of surety, even where the time given may have been with a view to protect the interests of the surety or for his benefit. It has also been held that where time is given for a part of the debt, the surety would be discharged only with regard to that part. Of course, if there is an express clause in the guarantee agreement, entitling the creditor to give such time, that agreement will hold good. If however, the contract to give time to the principal debtor is made by the creditor with a third person, and not with the principal debtor, the surety is not discharged (S. 136).

ILLUSTRATION

Where *C* the holder of an overdue bill of exchange drawn by *A*, as surety for *B* and accepted by *B*, contracts with *M* to give time to *B*, *A* is not discharged; also *mere forbearance* on the part of the creditor to sue the principal debtor or to enforce any other remedy against him does not, in the absence of any provision in the guarantee to the contrary, discharge the surety (S. 137).

“Mere forbearance” here means that there is no express agreement to give time.

ILLUSTRATION

B owes *C* a debt guaranteed by *A*. The debt becomes payable. *C* does not sue *B* for a year after the debt has become payable. *A* is not discharged from his suretyship.

If the creditor does any act which is *inconsistent with the rights of the surety* or omits to do any act which his duty to the surety requires him to do and the eventual remedy of the surety himself against the principal debtor is thereby impaired, the surety is discharged (S. 139).

ILLUSTRATIONS

(a) *B* contracts to build a ship for *C* for a given sum, to be paid by instalments as the work reaches certain stages, *A* becomes surety to *C* for *B*'s due performance of the contract. *C*, without the knowledge of *A*, prepays to *B* the last two instalments, *A* is discharged by the prepayment.

(b) *C* lends money to *B* on the security of a joint and several promissory note made in *C*'s favour by *B*, and by *A* as surety for *B*, together with a bill of sale of *B*'s furniture, which gives power to *C* to sell the furniture and apply the proceeds in discharge of the note. Subsequently, *C* sells the furniture, but owing to his misconduct and wilful negligence, only a small price is realized. *A* is discharged from liability on the note.

(c) *A* puts *M* as apprentice to *B*, and gives a guarantee to *B*, for *M*'s fidelity. *B* promises on his part that he will at least once a month see *M* make up the cash.

B omits to see this done as promised, and *M* embezzles. *A* is not liable to *B* on his guarantee (ills. to S. 139).

On the same principle, *if the creditor returns the securities* which he could realise and apply in discharge of his debts, the surety becomes exonerated to the extent of the value of such securities.

Release of a Co-surety

Where there are co-sureties, a *release* by the creditor of *one* of them *does not discharge the others*; neither does it free the surety so released from his responsibility to the other sureties (S. 138). *The rule is opposed to that in English Law* because there a release or discharge granted to one of the co-sureties operates also as the discharge of the others. The second part of the section retains the right of contribution against co-sureties in case one of the sureties is called upon to pay up the whole debt and does not so pay or where he pays more than his own true share of contribution as such a surety. This right of contribution can be enforced even when the surety did not know at the time of incurring liability that he was to be co-surety with others and also whether the sureties are joint or joint and several and whether instruments by which they are bound are the same or different as long as the engagement is the same with the principal. In the absence of a special agreement, joint sureties contribute equally.

Surety's Rights on Payments

When a surety pays what is due, or performs all that he is liable to perform where the guaranteed debt has fallen due, or the default of the principal debtor has taken place, *he is invested with all the rights which the creditor had against the principal debtor* (S. 140). In other words, the surety in such a case *is subrogated* in place of the creditor whom he pays out and becomes entitled to all the benefits and remedies the creditor was invested with against the principal debtor. Here he can recover the amount from the principal debtor with interest, and can claim the benefit of every security which the creditor had against the principal debtor at the time when the contract of suretyship was entered into and that too even if the surety did not know of the existence of such security and if the creditor loses or without the consent of the surety parts with such security, the surety is discharged to the extent of the value of the security (S. 141). Of course, here the *surety must have paid the whole debt*, because if he has only paid a part of it he

cannot claim a proportional right in these securities. If what was guaranteed was only a part of the debt then he can claim, on paying up that part, a pro rata share in those securities.

ILLUSTRATIONS

(a) C advances to B, his tenant Rs 2,000 on the guarantee of A. C has also a further security for the 2,000 rupees by a mortgage of B's furniture. C cancels the mortgage. B becomes insolvent and C sues A on his guarantee. A is discharged from liability to the amount of the value of the furniture.

(b) C, a creditor, whose advance to B is secured by a decree, receives also a guarantee for that advance from A. C afterwards takes B's goods in execution under the decree, and then without the knowledge of A, withdraws the execution. A is discharged.

(c) A, as surety for B, makes a bond jointly with B to C, to secure a loan from C to B. Afterwards, C obtains from B a further security for the same debt. Subsequently, C gives up the further security. A is not discharged (Illus. to S. 141).

The implied promise of the principal debtor in the contract of guarantee being to indemnify the surety, *the surety can claim only the amount he has rightfully paid* but not that which was paid wrongfully.

If, however, a guarantee has been obtained by *misrepresentation or concealment* of a material circumstance, the transaction is invalid (Ss. 142 & 143).

ILLUSTRATIONS

(a) A engages B as clerk to collect money for him. B fails to account for some of his receipts, and A in consequence calls upon him to furnish security for his duly accounting. C gives his guarantee for B's duly accounting. A does not acquaint C with B's previous conduct. B afterwards makes default. The guarantee is invalid.

(b) A guarantees to C payment for iron to be supplied by him to B to the amount of 2 000 tons, B and C have privately agreed that B should pay five rupees per ton beyond the market price, such excess to be applied in liquidation of an old debt. This agreement is concealed from A. A is not liable as a surety (Illus. to S. 143).

Co-sureties

If the guarantee includes *a contract* that the creditor shall not act upon the guarantee *until some other has joined in it as a co-surety* that being a *condition precedent* the guarantee will not be valid if that other person does not join (S. 144).

Where *two or more persons* are co-sureties for the same debt or duty, either jointly or severally, they are liable to pay, as between

themselves, each an equal share of the whole debt or that part of it which remains unpaid by the principal debtor (S. 146).

ILLUSTRATIONS

(a) *A, B and C are sureties to D for the sum of 3,000 rupees lent to E. E makes default in payment. A, B and C are liable, as between themselves, to pay 1,000 rupees each.*

(b) *A, B and C are sureties to D for the sum of 1,000 rupees lent to E and there is a contract between A, B and C that A is to be responsible to the extent of one quarter, B to the extent of one-quarter, and C to the extent of one-half. E makes default in payment. As between the sureties, A is liable to pay 250 rupees B 250 Rupees and C 500 rupees (Illus. to S. 146).*

If the co-sureties are bound in different sums, they are liable to pay equally as far as their respective obligations permit (S. 147).

ILLUSTRATIONS

(a) *A, B and C as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 10,000 rupees, B in that of 20,000 rupees, C in that of 40,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 30,000 rupees A, B and C are each liable to pay 10,000 rupees.*

(b) *A, B and C, as sureties for D, enter into three several bonds, each in a different penalty namely, A in the penalty of 10,000 rupees, B in that of 20,000 rupees, C in that of 40,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 40,000 rupees. A is liable to pay 10,000 rupees, and B and C 15,000 rupees each.*

(c) *A, B, C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 10,000 rupees, B in that of 20,000 rupees, C in that of 40,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 70,000 rupees. A, B and C have to pay each the full penalty of his bond. (Illus. to S. 147).*

Implied Promise to Indemnify Surety

There is an implied promise in every guarantee contract that the principal debtor will indemnify the surety and the surety is entitled to *recover from the principal debtor* whatever sum he *has rightfully paid under the guarantee* (S. 145).

ILLUSTRATIONS

(a) *B is indebted to C, and A is surety for the debt. C demands payment from A, and on his refusal sues him for the amount. A defends the suit, having reasonable grounds for doing so, but is compelled to pay the amount of the debt with costs. He can recover from B the amount paid by him for costs as well as the principal debt.*

(b) *C lends B a sum of money, and A, at the request of B, accepts a bill of exchange drawn by B upon A to secure the amount. C, the holder of the bill,*

demands payment of it from *A*, and, on *A*'s refusal to pay, sues him upon the bill. *A*, not having reasonable grounds for so doing, defends the suit, and has to pay the amount of the bill and costs. He can recover from *B* the amount of the bill, but not the sum paid for costs, as there was no real ground for defending the action.

(c) *A* guarantees to *C*, to the extent of 2,000 rupees, payment for rice to be supplied by *C* to *B*. *C* supplies to *B* rice to a less amount than 2,000 rupees, but obtains from *A* payment of the sum of 2,000 rupees in respect of the rice supplied. *A* cannot recover from *B* more than the price of the rice actually supplied (Illus. to S.145).

Promissory Notes and Bills in Lieu of Guarantee

The other method of guaranteeing without entering into an actual bond or agreement is to give a promissory note jointly and severally. Frequently a bill which is drawn and accepted is endorsed by a person, not because he is a party to the bill but because he acts in the capacity of a guarantor or surety. This form has one drawback, viz., that the banker will not here get the benefit of the protective clauses which a properly drawn guarantee form contains. In such forms the lender is allowed to present bills on the due date, if they are payable after the expiry of a specified period. He is here in the position of a holder in due course and in case of dishonour, he is bound to carry out all the duties of a holder in due course, whose bill has been dishonoured, i.e., in connection with noting, protest, giving notice of dishonour, etc.

SUMMARY

Contract of indemnity and guarantee are special types of contracts therefore they must have all the essentials of a valid agreement.

Definitions

1. Contract of Indemnity: "A contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person, is called a contract of indemnity" (S.124, Indian Contract Act).

2. Contract of Guarantee: "A contract of guarantee is a contract to perform the promise, or discharge the liability, of a third person in case of his default" (S.126, Indian Contract Act).

Difference between Indemnity and Guarantee

Indemnity	Guarantee
1. Only two parties—	1. Three parties—
(a) the indemnifier or promisor, and	(a) the creditor,
(b) the indemnified or promisee.	(b) the principal debtor, and
	(c) the guarantor or surety.

- | | |
|--|---|
| <p>2. The indemnifier's liability is primary and independent.</p> | <p>2. The surety's liability is secondary or collateral, the primary liability being that of the principal debtor.</p> |
| <p>3. It is not necessary for the indemnifier to act at the request of the debtor.</p> | <p>3. It is necessary for the surety to give his guarantee at the request of the debtor.</p> |
| <p>4. There is no existing debt but it is the possibility or risk of a contingency happening that the indemnifier undertakes to indemnify.</p> | <p>4. There is an existing debt or duty, the payment or performance of which the surety guarantees.</p> |
| <p>5. The indemnifier cannot sue third parties in his own name as there is no privity of contract unless there is an assignment of the contract.</p> | <p>5. The surety can sue the principal debtor in his own right.</p> |
| <p>6. There is only one contract <i>i.e.</i> between the indemnifier and the indemnified.</p> | <p>6. There are three contracts—
(1) between the principal debtor and the creditor;
(2) between the creditor and the surety; and
(3) between the surety and the principal debtor.</p> |
| <p>7. May be written or oral in both Indian and English law.</p> | <p>7. In Indian Law may be written or oral but in English Law in order to be actionable, a guarantee must be evidenced by some memorandum or note in writing.</p> |

Difference between Specific and Continuing Guarantee

- | Specific Guarantee | Continuing Guarantee |
|---|---|
| <p>1. A single transaction is guaranteed.</p> | <p>1. A series of transactions are guaranteed.</p> |
| <p>2. Comes to an end when the transaction is complete.</p> | <p>2. Extends over the whole series of transactions, therefore called 'continuing'.</p> |
| <p>3. Cannot be revoked by the surety.</p> | <p>3. Can be revoked as to future transactions.</p> |

Discharge of Surety

The surety is discharged in the following cases:

1. If the agreement between the principal debtor and the creditor is void, the surety is not bound.

2. If the creditor varies any term in the contract between the principal debtor and the creditor, without the surety's consent, the surety is discharged.
3. If the creditor releases the principal debtor either by an agreement or by any act or omission of the creditor, the surety is discharged.
4. If the creditor, without the surety's consent, compounds with the principal debtor or agrees not to sue him, the surety is discharged.
5. If the creditor does anything which is inconsistent with the rights of the surety or omits to do any act which his duty to the surety requires him to do, and the eventual remedy of the surety against the principal debtor is impaired, the surety is discharged.
6. If the creditor returns the securities which he could have realised and applied in discharge of the debt, the surety is discharged to the extent of the value of such securities.
7. If the guarantee is obtained by misrepresentation, the surety is discharged.
8. If the guarantee is obtained by concealment of a material fact, the surety is discharged.
9. If the guarantee is given on the understanding that some other person will join the surety and that person does not join, the surety is discharged.
10. In the case of a continuing guarantee if the surety revokes it, he will be discharged as to future transactions.

Rights of Surety

I. Against the Principal Debtor

1. *On Payment*, the surety gets all the rights of the creditor against the principal debtor.
2. The surety can *recover* from the principal debtor all sums he has *rightfully* paid, *i.e.*, an implied promise to be indemnified.

II. Against the Creditor

1. *Before the principal debt is paid*, the surety has the right to file a *suit for a declaration* that the principal debtor will be liable for the debt.
2. *On payment*, the surety is entitled to the benefit of every security which the creditor has against the principal debtor whether or not the surety knows of the existence of such security.

TYPICAL QUESTIONS

1. Define "Contract of Indemnity"
or
What are the rights of a surety as against
 - (a) Principal Debtor,
 - (b) Co-surety, and
 - (c) Creditor.
2. *A* is indebted to *C* in the sum of Rs 3,000, to be repaid in three instalments of Rs 1,000 each, and *C* is surety for the payment of the instalments. *A* being unable to pay the first instalment, persuades *B* to allow 6 months' further time to do so. He subsequently fails to pay any of the instalments and *B* then files a suit against *C* to recover the whole amount. What are *C*'s liabilities towards *B*?
3. (a) 'The liability of the surety is secondary'.
'The liability of the surety is co-extensive with that of the principal debtor'.
Elucidate the above statements.
 - (b) *B* appointed *X* his agent to collect his rent and required him to execute a fidelity bond in which *C* was a surety. Some time after the execution of the bond, *C* died and *X* committed various acts of dishonesty. Is *C*'s estate liable for the loss caused to *B*?
4. (a) Discuss clearly the nature of a surety's liability. When is he discharged from his obligations?
 - (b) The *B. Bank* lent money to *D* on the guarantee of *P*. The guarantee was a collateral security. The demand for payment of the liability of the principal debtor was the only condition for the enforcement of the bond. That condition was fulfilled. Neither the principal debtor nor the surety discharged the admitted liability. The *B. Bank* filed a suit and obtained a decree against both containing a direction that 'the *B. Bank* shall be at liberty to enforce its dues in question against the surety only after having exhausted its remedies against the principal debtor'. Examine the validity of the direction.
5. "The liability of the surety is co-extensive with that of the principal debtor, unless it is otherwise provided by the contract". Discuss.
6. Write short notes on
Termination of guarantee.
7. (a) *C* agrees to appoint *B* as his clerk to sell goods, on a yearly salary. *A* becomes surety to *C* for *B*'s duly accounting for the money received by him as clerk. *B* receives Rs 2,000 and embezzles that amount. Thereafter *C* and *B* agree that *B* should be paid a commission on the goods sold by him, and not a fixed salary.
Subsequently, *B* receives Rs 3,000 and embezzles that amount. What is *A*'s liability to *C*?

- (b) What is the position of a surety when a creditor forbears from enforcing his remedy against the principal debtor?

8. (a) *A*, in consideration of *B*'s discounting, at *A*'s request, Bills of Exchange for *C*, guarantees to *B* for 12 months the due payment of all such bills to the extent of Rs 5,000. *B* discounts bills for *C* to the extent of Rs 2,000.

Afterwards at the end of three months, *A* revokes the guarantee. What is the liability of *A* to *B* in respect of bills discounted by *B* for *C* during the said period of three months and bills discounted by him thereafter?

- (b) *A* becomes surety to *C* for *B*'s conduct as manager in *C*'s bank.

Afterwards, *B* and *C* contract, without *A*'s consent, that *B*'s salary shall become liable for one fourth of the losses on overdrafts. *B* allows a customer to overdraw, and the bank loses a sum of money. What is the position of *A* in respect of this loss?

- (c) What is the liability of a surety when the creditor omits to sue the principal debtor within the period of limitation?

9. *A*, *B* and *C*, as sureties for *D*, enter into three separate bonds, each in different penalty, namely *A* in the penalty of Rs 10,000, *B* in that of Rs 20,000. *C* in that of Rs 40,000, conditioned for *D*'s, duly accounting to *E*. *D* makes a default to the extent of Rs 40,000. Discuss the respective liabilities of *A*, *B* and *C*.

10. *A*, *B* and *C*, as sureties for *D* enter into three separate bonds, each in a different penalty, namely, *A* in penalty of Rs 10,000, *B* in that of Rs 20,000, *C* in that of Rs 40,000, conditioned for *D*'s, duly accounting to *E*. *D* makes a default to the extent of Rs 40,000. Discuss the respective liabilities of *A*, *B* and *C*.

11. Distinguish between:

- (a) A contract of indemnity and a contract of guarantee, giving examples of each.
- (b) A specific and a continuing guarantee.

Chapter 13

CONTRACTS

Bailment and Pledge

I. BAILMENT

Definition of Bailment

BAILMENT IS *defined* by Section 148 as the “*delivery*” of goods by one person to another for some purpose, upon a contract that they shall, when the purpose is accomplished, be *returned* or otherwise disposed of according to the directions of the person delivering them.

The person delivering the goods is called the “*bailor*” and the person to whom they are delivered is called the “*bailee*”, and the transaction is called “*bailment*”.

If a person already in possession of the goods of another contracts to hold them as bailee, he thereby becomes the bailee, and the owner becomes the bailor of such goods although they may not have been delivered by way of bailment.

In a case where the thing delivered is not to be returned the transaction cannot be called a bailment. The bailment may be either by way of deposit, in which case the person to whom it is

delivered has no right to use it, or the goods may have been delivered with the bailor's consent for gratuitous use or by way of hire or pawn. In short, the goods here are *delivered for a temporary purpose*.

Bailor's Duties

If goods bailed carry some *defect* which is likely to expose the bailee to any extraordinary risk, or is likely to interfere with his use, the *bailor must disclose such faults*, failing which the bailor would be responsible to the bailee for damages arising out of such defect, with this *difference* that, in case the goods are bailed *for hire* the bailor will be responsible irrespective of the fact that the bailor was not aware of the existence of such defect.

ILLUSTRATION

A lends a horse to *B* knowing it to be vicious, *A* must disclose this fact, even if the bailment was *gratuitous*, to *B*, otherwise in case of injury to *B*, *A* would be responsible for the damage sustained. If, on the other hand, the horse was hired, *A* would be responsible for damages even where *A* was ignorant of the defect (S. 150).

Bailee's Duties

Where the goods are left with the bailee, the bailee must take as much care of the goods as a man of ordinary prudence would, under similar circumstances, take of his own goods of the same bulk, quality and value as the goods bailed (S. 151), *i.e.* he is liable for *negligence only*, in the absence of a contract to the contrary.

The Indian Law thus does not recognize any degree of care, as in the case of English law, but clearly states that the bailee must take as much care of the goods as a man of ordinary prudence would take of his own goods of the same bulk, quality and value. *The English Law*, on the other hand, *makes distinctions as to the degree of care*, differentiating negligence into "ordinary" and "gross", according to whether the bailee is a gratuitous or a paid bailee but such a distinction is not very satisfactory as it is not always possible to draw any real distinction between the two.

The bailee is responsible not only for loss caused through his own negligence but also for that caused through the negligence of his servants in the regular course of their employment. If, however, the loss is caused through the act or default of a third party, the bailee would not be liable if he can show that the loss could not have been prevented even with reasonable care and diligence. The

same would be the case if the bailee's servants caused the loss or damage, while acting outside their ordinary course of employment under him. On the same principle, the liability of a guest in a hotel or inn with regard to the furniture he uses is the same as that of a bailee.¹

It is the *duty of a bailee* to act with regard to the goods bailed strictly in accordance with the conditions of the bailment. If *not*, the bailor would be at liberty to declare the bailment void at his option.

ILLUSTRATION

A lends to *B* his horse for hire for his own riding but *B* drives the horse for his carriage. This breach of condition gives *A* the *option to terminate* the bailment (S. 153). He is also entitled to claim the damages, if any, that may arise through this breach of condition (S. 154).

In the case of an *inn-keeper*, according to *Common Law*, he is liable as an insurer of goods for loss in connection with the luggage or articles belonging to his guest, *i.e.* unless the loss or damage is caused through the Act of God or the King's enemies or the guest's own negligence.² In the opinion of Sir Dinshah Mulla, the liability of an inn-keeper in *Indian Law* is the same as that of an ordinary bailee under Sections 151 and 152.

Common Carriers, like inn-keepers, were liable under the *Common Law* as insurers of goods. In India the same principles applied but by the Carriers Act of 1865 a common carrier is permitted to limit his liability by special contract in the case of certain goods. Thus the liability of common carriers as bailees is not governed by the Indian Contract Act but by the *Common Law* as modified by the Carriers Act.

BAILMENT FOR REWARD

Cases of bailments for reward are divided into two classes, *viz.*

- (1) those in which a reward is received by the bailor, and
- (2) those in respect of which the reward is to be received by the bailee.

Reward to Bailor

Where the bailor receives a reward from the bailee, as in the case of a taxi cab driver who took the taxi, used it, paying 75 per

¹ *Rampal Singh v. Murrey and Co.* 22 All. 164

² *Caley's Case*, 1 Smith's L.C. 13th ed., 120

cent of the receipts to the owner of the taxi cab, even though the driver wore the uniform of the owner of the taxi cab and bought his petrol from the owner out of his receipts, it was held that he was a bailee and not a servant.³ The other example of a bailment for reward to the bailor, arises in cases of contracts on a hire and purchase basis, where the bailee, in consideration of paying a certain number of hires, is entitled to become the owner of the bailment on paying all the hires.

Reward to Bailee

This happens where goods are warehoused with a *muccadum* or a warehouseman, who gets a certain hire for storing them on behalf of the merchant owner during the period they remain in his custody. Another case is where an article is entrusted to be worked upon, as for example, where a watch is left with a watch-repairer for repair, or gold and diamonds are left with a jeweller to be made into an ornament, as the watchmaker in the first case, or the jeweller in the second becomes a bailee for reward.

If the goods are to be kept or to be carried or to have work done upon them by the bailee for the bailor without any remuneration, the bailor must repay to the bailee the necessary expenses incurred by him for the purpose of the bailment (S. 158).

Railway Companies

In *Indian Law* railway companies entrusted with goods to be carried from one place to another are governed by the Indian Railways Act 1890 as amended by the Indian Railways (Amendment) Act 1961.

The Company's liability comes into operation as soon as goods are tendered and accepted even though no receipt is given.⁴ It has also been held that when goods are carried by several carriers in succession and they are consigned to one of them and there is short delivery at the destination the fact that loss occurred when they were carried by one of the other carriers does not absolve the last carrier because the contract here was one and indivisible.⁵ It has also been decided in a Bombay case that where packages were received safe but the contents of some were missing, the railway company was not liable though wilful default was proved.

³ *Smith v. General Motor Cab Co.*, (1911). 27 T.L.R. 317

⁴ *G. I. P., Rly. Co. v. A. B. Tamboli*, 28 Bom L. R. 718

⁵ *India G. N. & Rly. Co. v. Girdharilal Gordhan Das*, 54 Cal. 430

In *England* railways as carriers of goods are regarded as common carriers.

In *India* railways were regarded as bailees but since the 1961 amendment of the Railways Act, 1890, the railways are responsible as common carriers for the carriage of animals and goods.

For further details see the chapter on "Carriage of Goods".

Mixing up of Goods Bailed

If the bailee mixes the goods of the bailor with his own *with the consent of the bailor*, the bailor and bailee will have an interest in the mixture in proportion to their respective shares in the mixture (S. 155).

If the mixture is made *without the bailor's consent* and (a) if the goods *can be separated* or divided the bailor can claim his share of the mixture and the damage, if any, arising from the mixture and the bailee has to bear the expense of separation or division (S. 156).

ILLUSTRATIONS

(a) *A* bails 100 bales of cotton marked with a particular mark to *B*. *B*, with *A*'s consent, mixes the 100 bales with other bales of his own bearing a different mark. *A* is entitled to have his 100 bales returned, and *B* is bound to bear all the expense incurred in separation of the bales and any other incidental damage.

(b) If the goods *cannot be separated*, the bailee would have to make compensation for the loss of the goods (S. 157).

ILLUSTRATION

A bails a barrel of Cape flour worth Rs 45 to *B*. *B*, without *A*'s consent mixes the flour with country flour of his own, worth only Rs 25 a barrel. *B* must compensate *A* for the loss of his flour.

Termination of the Bailment

When the purpose for which the goods were bailed, or the time for which they were so bailed has expired, the *bailee must return* or deliver according to the bailor's instructions, *the goods bailed without demand*, and if he does not do so, he would be responsible to the bailor, for any destruction, loss, or deterioration caused to the goods from that time (Ss. 160 & 161).

If, however, the goods are lent *gratuitously*, the bailor has the right to request their return at any time, even though he lent them for a specified time or purpose. This is subject to this *exception* that where, relying on such a loan made for a specified time or pur

pose, the bailee has acted in a manner as would cause him loss, through the return of the goods before the time stipulated, exceeding the benefit actually derived by him from the loan, the lender or bailor must, if he compels the return, indemnify the borrower for the amount by which the loss so occasioned exceeds the benefit so derived (S. 159). A gratuitous bailment terminates at the *death* either of the bailor or of the bailee (S. 162).

In the absence of a contract to the contrary, not only is the bailee bound to return the goods bailed, but he should also hand over the *increase or profit*, if any, which may have accrued from the goods during the bailment.

ILLUSTRATION

Where *A* leaves a cow in the custody of *B* to be taken care of and the cow has a calf, *B* is bound to deliver the cow as well as the calf to *A* (S. 163).

Bailment by Joint Owners

When the bailed goods belong to several joint owners, the bailee may deliver them to, or according to the directions of, any one joint owner, without the consent of all, provided there is no agreement to the contrary (S. 165).

Title of the Bailor

The bailor is responsible to the bailee for any loss which the bailee may sustain as a result of the bailor not being entitled to make the bailment or to receive back the goods or to give directions respecting them (S. 164).

If the bailor has no title to the goods, and the bailee, in good faith, delivers them back to, or according to the directions of the bailor, the bailee is not responsible to the owner in respect of such delivery (S. 166).

The third party who claims the goods bailed may apply to the Court to stop the delivery of the goods to the bailor and to decide the title to the goods (S. 167).

A Finder of Goods

On the same principles, a person who finds goods belonging to another and takes them into his custody is subject *to the same responsibilities as a bailee* (S. 71).

The finder of goods is entitled to *retain* the goods against the owner until he receives compensation *for the trouble and expense* he

may have voluntarily incurred with a view to *preserve the goods and to find out* the owner. He has *no right*, however, to *sue* the owner for the trouble and expense. His remedy is *only retention* with a view to compel the other side to pay. If, however, a *specific reward* was offered for the return of lost property, the finder would then acquire *the right both of suing for such a reward and of retaining* the goods until the reward is received (S. 168).

The Indian law thus gives the finder a lien on the goods for his expenses and the reward. Where the owner cannot be found with reasonable diligence, or where he is found, but refuses upon demand to pay the lawful charges of the finder, and where the thing so found is in danger of perishing, or losing the greater part of its value, or where the lawful charges of the finder amount to two thirds of the value of the goods found, the finder is entitled to *sell* the goods (S. 169).

Bailee's Claim for Service

The bailee who has, in accordance with the purpose of the bailment, rendered any service involving the exercise of labour or skill in respect of the goods bailed, has also the right to retain the goods until he receives due remuneration for the service rendered in the absence of an agreement to the contrary (S. 170).

ILLUSTRATIONS

(a) *A* delivers a rough diamond to *B* a jeweller to be cut and polished, which is accordingly done. *B* is entitled to retain the stone till he is paid for the services he has rendered.

(b) *A* gives cloth to *B* a tailor to make a coat. *B* promises *A* to deliver the coat as soon as it is finished and to give *A* three months credit for the price, *B* is not entitled to retain the coat until he is paid (ills. to S. 170)

It must, however, be noted that the service rendered *must involve skill or labour*, and therefore a person who takes in animals only to feed them does not come under the rule; but a horsebroker or veterinary surgeon, who uses skill or labour would be the proper person to put forward such claim.

Lien

Liens are of three main types: (1) Possessory lien, (2) Equitable lien and (3) Maritime lien.

(1) A *possessory lien*, may be defined as the right which a person has to retain that which is in his possession but which belongs

to another until certain demands of the person in possession are satisfied. A possessory lien may be particular or general. The lien which we have hitherto dealt with is called the *bailee's particular lien* as apart from the *general lien of bankers, factors, wharfingers, attorneys of a High Court and policy-brokers* who can retain as a security for a general balance of account, any goods or securities, or papers, bailed to them, unless there is an express agreement to the contrary (S. 171).

A *general lien* is a right which has arisen by custom in particular trades or professions or by contract to retain goods or other security of valuables which come into the possession of these persons in the regular course of *their business or profession* for any money which may be owing to them by the owner to whom these goods, valuables or securities belong.

Thus bankers have a general lien on cash and securities belonging to their customers, which are deposited with them in the regular course of their business as bankers, for any money that may be due to them, as bankers. If, however, there is a specific agreement with the banker to the effect that he will not have a general lien or that he gives it up, that will be binding.⁶ It may be added that in case of valuables or securities deposited only for safe custody, this lien does not arise. With regard to securities on which the banker is given the power to collect interest and dividend, however, such a lien would extend. But the lien would not extend to title deeds casually left with bankers on which the bankers had previously refused to make an advance.

On the same principle, an attorney or solicitor of the High Court, has a lien on all papers and documents belonging to his client that may be in his possession in his professional capacity for which fees are due to him. It may be noted here that the solicitor who is discharged by his client has a lien for his costs but one who has himself refused to act has not.

It is also considered doubtful whether an auditor has any right of general lien on the books he has audited even though he may have possession of them. In the case of wharfingers dealing with the goods as wharfingers, a general lien on these goods arises for their charges against the owner of the goods.

The Indian Contract Act provides for the following lien—

(i) The particular lien of the *finder* of goods (S. 168).

⁶ *Kunhan Manyan v. Bank of Madras*, 19 Mad. 234

- (ii) The particular lien of *bailees* (S. 170).
- (iii) The general lien of *bankers, factors, wharfingers, attorneys of High Courts and policy brokers* (S. 171).
- (iv) The particular lien of *pawnees* (S. 173 and 174).
- (v) The particular lien of *agents* (S. 221).

(2) An *equitable lien* creates a charge on the property and whoever takes the property thereafter with notice of such lien, takes it subject to the lien. For example, an unpaid vendor of immovable property or a purchaser of immovable property who has prepaid the price has an equitable lien on the property for the amount due. An equitable lien is enforceable by sale.

(3) A *maritime lien* is a lien on a ship, its furniture, tackle, cargo and freight for the payment of a claim under the maritime law. It is available to the master of the ship for his wages and disbursement, to the holder of a bottomry bond for the amount of the bond, to salvors on the property which is saved, and to persons who claim damages against the ship in respect of a collision due to the ship's negligence. A maritime lien is enforced by arresting the ship and by proceedings in the Admiralty Court.

II. PLEDGE

Definition of Pledge

Pledge is defined as a bailment of goods as *security* for the payment of a debt or performance of a promise. The bailor here is called the "pawnor" and the bailee the "pawnee" (S. 172). Any class of goods, valuables, documents, etc., may be made the subject-matter of a pledge. There must be, however, a constructive or actual *delivery*.

The pawnee has a *right to retain* the goods pawned with him until the debt for which the pawn is created is paid; or the promise for the performance of which the pledge was made is fulfilled. This right extends to the *interest on the debt* plus all necessary expenses incurred by him in respect of the possession or for preserving the goods pledged (S. 193). For extraordinary expenses there is no right to retain *i.e.*, no lien but only a right of action (S. 175).

Pawnor's Default

Where the pawnor makes default in the payment of his debt, or the performance of his promise at the stipulated time in respect of which the goods were pledged, the pawnee may,

(1) bring a suit against the pawnor upon the debt or promise, and retain the goods pledged as a collateral security, or

(2) he may sell the thing pledged, on giving the pawnor reasonable notice of the sale. If the proceeds of such a sale are less than the amount due in respect of the debt or promise, he can recover the balance from the pawnor. If, on the other hand, there is a surplus he should return the excess to the pawnor (S. 176).

From this it must not be thought that because there has been a default by the pawnor his right to redeem the pledge has been lost. The right, on the contrary, continues until the actual sale of the goods and therefore *the pawnor can redeem the goods pledged at any time before the actual sale*, on payment of additional expenditure, if any, that may have been the result of his default (S. 177). It may be added here that in this case the pawnee is allowed to sell without a reference to the Court. The sale may be by public auction or by private agreement. The period of limitation in the case of a loan on a pledge is three years, to run from the date of the loan. In the case of a promise, however, for the keeping of which the pledge is made, the years run from the date of the breach of the promise.

It has been held by the Supreme Court in *The Bank of Bihar v. The State of Bihar and others*⁷ the rights of the pawnee who had parted with money in favour of the pawnor on the security of the goods cannot be defeated by the goods being lawfully seized by the Government and the money being made available to other creditors of the pawnor, without the claim of the pawnee being fully satisfied. The pawnee has a special property and a lien, which is not of ordinary nature, on the goods and so long as his claim is not satisfied no other creditor of the pawnor has any right to take away the goods or its price. Therefore after the goods had been seized by the Government it was bound to pay the amount due to the pawnee and the balance could be made available to satisfy the claim of other creditors of the pawnor. But by a mere act of lawful seizure the Government cannot deprive the pawnee of the amount which was secured by the pledge of the goods.

Who May Pledge

Of course *the owner* may pledge his goods but besides that a pledge may be made by a *mercantile agent who is in possession of goods or documents of title to goods with the consent of the true owner*. Thus a bill of lading, a dock warrant, a warehouse-keeper's certi-

⁷ (1972) 2 S.C.J. 661

ificate, wharfinger's certificate, or warrant or order for delivery, or any other document of title may be pawned in the above case and the pledge would be valid as long as the mercantile agent makes the pledge in the ordinary course of his business, and the pawnee acts in good faith and without notice that the pswnor has no authority to pledge (S. 178).

The fundamental rule of the law of transfer of property is that no man can give a better title than he himself possesses, *nemo dat quod non habet*. As a corollary of this fundamental rule, no one can pledge goods unless he is the owner or lawfully represents the owner. Consequently, if a person obtains a pledge of goods from another who has no valid title to make a pledge, the former acquires no security over them. But another principle of law embodied in Section 178 of the Contract Act is that a person who takes from one whom he knows to be 'a mercantile agent' and who is in possession of the goods, gets a notice that the pledgor had no title or authority to pledge. Under the first principle if a person deals with goods of another without his authority or consent, the transaction is nugatory against the owner. The second principle steps in to protect those who in good faith deal with a mercantile agent who is known to them as such and who is in possession of the goods.⁸

A pledge can also be made by a person in possession under a voidable contract if the goods are pledged before the contract is rescinded and the pawnee acts in good faith and without notice of the pawnor's defective title (S. 178 A). Section 30 of the Indian Sale of Goods Act also provides for a pledge or other disposition of goods by a seller or buyer in possession of goods or documents of title to goods after sale. It should be noted here that what is meant is that the article should be in possession, as distinguished from mere custody without authority to deal with it. A servant left in charge of the goods his master or a wife left in charge of her husband's goods cannot pledge them.⁹

If the interest of the pawnee is limited, he can pledge the goods or the documents to the extent of his interest (S. 179). It may be added that if a third person injures the goods pledged, or deprives the bailee of the use or possession of them, the bailee is entitled to all the remedies that the owner may have had either the bailor or the bailee may bring a suit against the offending third party. The compensation obtained in such a suit is divisible

⁸ *Poonam Shankar & Co., v. Deepchand Siremal*, 1971, M.P.L.J., 808

⁹ *Biddomoye v. Sitaram* 1. Cal. 497; *J.W. Seager v. Hukma Kessa* 24 Bom. 458

between the bailor and the bailee according to their respective interests.

Difference between Pledge and Mortgage of Goods

In the case of a pledge, the possession of goods but not their ownership, passes to the creditor or pawnee, whereas in the case of a mortgage of goods, it is the property in goods, i.e. the ownership, which is transferred to the mortgagee subject to the mortgagor's right to redeem, the possession, until default, generally remaining in the mortgagor. As a pawnee is not the legal owner he has no power to foreclose but has only power to sell.

SUMMARY

Essentials of Bailment

1. Delivery.
2. Of goods-movable property.
3. For some purpose.
4. Return of the goods when the purpose is accomplished.

Liability of Bailee

The bailee is liable only for loss or damage due to his negligence or the negligence of his duly authorised agent.

Duties of Bailee

1. To take care of the goods bailed—the test is the care expected of a man of ordinary prudence if the goods had been his own.
2. To act strictly in accordance with the conditions of the bailment and not to make any unauthorised use of the goods.
3. Not to mix the bailor's goods with his own without the bailor's consent.
4. To return the goods when the purpose is over or to deliver them according to the instructions of the bailor.
5. To deliver to the bailor any increase or profit which may have accrued from the goods bailed, unless there is any contract to the contrary.

Rights of Bailee

1. Particular lien for labour or service rendered to the goods.
2. General lien if the bailee is a banker, factor, wharfinger attorney of High Court or policy broker.

3. To be indemnified for any loss sustained as a result of a breach of warranty of authority.

Liability of Bailor

1. To pay damages for loss arising from the bailor's failure to disclose known faults in the goods bailed.

2. To bear necessary expenses incurred by the bailee in the case of a gratuitous bailment.

3. To bear extraordinary expenses of the bailment.

4. To indemnify the bailee for any loss sustained by the bailee due to the bailor's breach of warranty of title to the goods.

Duties of Bailor

1. (a) In the case of a gratuitous bailment, to disclose faults in goods bailed of which he is aware and which materially interfere with the use of them, or expose the bailee to extraordinary risks.

(b) In the case of a bailment for hire, the bailor is responsible whether he was or was not aware of such faults.

2. To indemnify the bailee for necessary expenses in the case of a gratuitous bailment.

3. To receive back the goods or to give directions regarding them.

4. To indemnify the bailee for any loss sustained by the bailee due to a breach of warranty of title.

Rights of Bailor

1. To enforce by suit all the liabilities or duties of the bailee.

2. To demand a return of the goods at any time in the case of a gratuitous bailment, subject to the bailee's right to be indemnified if the immediate return of the goods would cause him more loss than benefit.

3. To avoid the contract if the bailee does any act with regard to the goods bailed which is inconsistent with the conditions of the bailment.

Termination of Bailment

The contract of bailment is terminated in the following circumstances:—

1. On the expiry of the specified time, if any.

2. On the fulfilment of the purpose.

3. On the commission by the bailee of any act inconsistent with the terms of the bailment.

4. By the bailor revoking a gratuitous bailment.

5. On the death of the bailor or bailee in the case of a gratuitous bailment.

Rights of Finder of Goods

1. To sue for any specific reward offered.
2. To retain goods until he receives compensation for trouble and expense voluntarily incurred by him to preserve the goods and to find the owner.
3. To sell the goods when the owner cannot be found or refuses to pay the finder's lawful charges, if
 - (a) the goods are in danger of perishing or of losing the greater part of their value, or
 - (b) the lawful charges of the finder amount to two thirds of the value of the thing found.

PLEDGE

Difference between Bailment and Pledge: A pledge is a type of bailment, the only difference being in the purpose.

Bailment	Pledge
Any purpose	Only purpose is as security (a) for the payment of money or (b) the performance of a promise.

Who Can Pledge

1. The owner.
2. The owner's duly authorised agent.
3. A mercantile agent who is in possession of the goods or documents of title with the consent of the owner.
4. A seller who is in possession after sale or a buyer who has obtained possession before sale.
5. A person in possession under a voidable contract, before the contract is rescinded.
6. A person with a limited interest—in such a case the pledge is valid to the extent of such interest.
7. One of several co-owners who is in sole possession with the consent of his co-owners.

Rights of Pledgee

1. Particular lien for payment of the debt or performance of the promise as well as for interest on the debt and necessary expenses.
2. To claim extraordinary expenses incurred by him for preservation of the goods.
3. To sue the pledgee in respect of the debt or promise and to retain the goods as collateral security.

4. To sell the goods after giving the pledgor reasonable notice of the sale.

Rights of Pledgor

1. To recover the goods on payment of the debt or performance of the promise.
2. To redeem the pledge at any time after default but before the actual sale.
3. To enforce proper maintenance of the goods pledged.

TYPICAL QUESTIONS

1. What is a Bailment? What are the duties of a Bailee?
2. Write short notes on the following:
 - (a) Contract by a pledgor that the pledgee may sell the pledged goods without giving notice to the pledgor.
 - (b) Lien of a bailee.
 - (c) Gratuitous bailment.
3.
 - (a) Discuss the right of an owner of goods to create a pledge over the goods by delivering to the lender documents of title relating to the goods.
 - (b) A bank, lending against pledge of goods, takes from the borrower a document by which the borrower agrees that the bank may without giving notice to the borrower about sale of the goods, sell the goods in enforcement of the pledge. Discuss
4. State, as briefly as you can, the points of distinction between—
 - (a) General lien and particular lien.
 - (b) Pledge of movables and hypothecation of movables.
5.
 - (a) Define "Bailment". What is bailee's particular lien?
 - (b) What are the rights of bailor and bailee against third parties?
 - (c) What are the duties and responsibilities of a bailor?
6.
 - (a) Discuss the rights and duties of a finder of lost goods.
 - (b) Discuss the Pawnee's right when the Pawnor makes default in the payment of the debt.
7. Distinguish between:
 - (a) Bailment and Pledge.
 - (b) General Lien and Particular Lien.
8. Write short notes on:
 - (a) Pledge
 - (b) Lien
 - (c) Bailee's duty of care to the Bailor's goods.

9. (a) Discuss whether an owner of goods can by delivering to a bank, documents of title relating to his goods, create a valid pledge over the goods in favour of the bank.
 - (b) Discuss the position of a pledgee of goods who sells the goods pledged without giving the pledger notice of sale of the goods.
 - (c) Distinguish between a pledge, a hypothecation and a mortgage, of movables.
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10. (a) *A* and *B* leave a box with Bank *X* for safe custody. *A* alone then writes to bank *X* to deliver the box to another bank *Y* for safe custody. How would you advise bank *X*?
 - (b) *X*, the owner of certain goods, books the goods by railway for carriage from *T* to *D*. He then delivers the railway receipt to Bank *M* and obtains an advance from that bank against the railway receipt. Does Bank *M* have a valid pledge over the goods?
 - (c) *P* pledges goods with *Q* and agrees that *Q* may sell the goods without giving *P* notice of sales. Can *Q* sell the goods without giving notice to *P*?

Chapter 14

CONTRACTS

Agency

Definition of Agent

AN AGENT is defined as a person employed to do any act for another or to represent another in dealing with third persons. The person for whom such an act is done is called the *principal* (S. 182).

Thus it will be noticed that somebody must be *employed* for the purpose of doing a particular thing on behalf of the principal, and thus all the actions of persons so employed, while acting in the course of that employment and under the express or *implied authority* of the principal, would be binding on the principal. This is based on the Latin maxim *Qui facit per alium facit per se*—he who does through another does it himself. It must be remembered that it is not mere employment that creates an agency, but *employment for the purpose of putting the principal into legal relations with others*.

The person who employs an agent must have himself the legal capacity to do an act for which he employs the agent, though it is not necessary that an agent should be similarly capacitated because an agent is regarded as a mere instrument in the hands of his prin-

principal. Section 183 clearly states that any person who is of the age of majority according to the law to which he is subject, and who is of sound mind, may employ an agent, whereas with regard to the agent himself, Section 184 clearly indicates that as between the principal and the third person any person may become an agent, but no person who is not of the age of majority and of sound mind can become an agent so as to be responsible to his principal. In other words, if a person employs an agent who is a minor the acts of the minor agent will bind the principal as far as they are done in the regular course of his agency, but if that minor agent violates any instruction of the principal, the principal cannot sue his minor agent.

Gratuitous and Paid Agent

It is again not necessary that the agent should get any consideration (S.185). *The only point of difference between a gratuitous agent and a paid agent* is that a gratuitous agent is not bound to do any work entrusted to him by his principal, but if he enters upon the work at all, he must do it properly and to the satisfaction of his principal. Thus a servant may be his master's agent if authorized by his master to do any particular act, but simply because he happens to be a servant he does not become an agent for that reason alone.

Authority of Agent

The authority of the agent may be either express or implied (S.186). An authority is said to be express when it is given by words spoken or written, whereas an authority is said to be implied when it is to be inferred from the conduct of the principal or the circumstances of the case and things spoken or written, or the ordinary course of dealing, may be accounted circumstances of the case (S.187). If a person gives another an authority to act on his behalf by a power of attorney, or by a letter, or by stating that order in so many words, the authority is said to be express. If, on the other hand A's servant was in the habit of going and buying goods on credit in A's name, and when the bills were presented by the tradesman to A, A was in the habit of paying them, that act would be construed as an authority given by implication, and if, therefore, after the servant's dismissal, the servant buys goods on his master's credit and disappears, the master, not having informed the tradesman of this dismissal in time, will be responsible.

More than one person may be employed to act as agent either jointly or severally. If there is nothing to show as to how this authority is to be exercised, it is *presumed* to be *joint* in which case

they should all concur in the execution of their authority in order to bind the principal [*Brown v. Andrew* (1849) 18 L.J.Q.B. 153. In re *Liverpool Household Stores* (1890) 59 L.J. Ch. 616]. This is not so in the public affairs where a large number is appointed, when the majority can act.

More than one person may appoint an agent, in which case the agent is responsible to them jointly and if he accounts to any one of them separately, he will still remain liable to his other joint principals (*Raghbar Dayal v. Firm Piare Lal* 145 I.C. 178).

An agent who has authority to do an act has authority to do every lawful thing which is necessary in order to do such act. An agent having authority to carry on a business has authority to do every lawful thing necessary for the purpose, or usually done in the course of conducting such business.

ILLUSTRATIONS

(a) *A* is employed by *B* residing in London, to recover at Bombay a debt due to *B*. *A* may adopt any legal process necessary for the purpose of recovering the debt, and may give a valid discharge for the same.

(b) *A* constitutes *B*, his agent, to carry on his business of a ship-builder. *B* may purchase timber and other materials, and hire workmen, for the purpose of carrying on the business (S.188).

Creation of Agency

There is no particular form of agreement or contract or document necessary to create an agency. In fact, in actual mercantile practice, many agencies are created orally or through implication, such as where a person orders his broker to buy goods for him or to secure for him a particular form of insurance policy, there is an agency created by an oral arrangement, the details of which are implied by the custom and practice attaching to such transactions.

Agency relations may be established by—

- (1) express appointment by the principal, as described above;
- (2) agency by implication of law;
- (3) agency by necessity;
- (4) agency by estoppel; and
- (5) agency by ratification.

1. **Agency by Express Appointment:** Where an Agency is created by words, spoken or written, the agency is said to be created by express appointment or agreement. For example, it is usual, where important officers and servants are given authority to act on behalf

of their masters or principals in order to bind them in connection with various transactions, to give them a *power of attorney* in the form of a written document authorizing them to act in such capacity. In such cases, care should be taken to mention specifically all the terms of the agency concerned and as far as possible, nothing should be left to implication.

Agencies created to *transfer or assign immovable property* should be in writing and registered in *India*, whereas in English law, they should be made by a deed. In other words, an agent appointed to enter into a contract under a deed should have his authority in writing under a similar document except where the principal orders an agent in his presence to enter into a contract on his behalf, that fact was not permitted in England to be taken as a defence because the authority was not under seal, whereas the document which he signed was under seal.¹ This is known as *express appointment*, i.e., an appointment by an actual agreement.

2. Agency by Implication: In this case the agency is created through implication inferred from the relation of the parties (e.g., master and servant, husband and wife) or from conduct. An auctioneer appointed to sell by public auction is to a certain extent an agent by implication; or a person left in charge of a shop by the owner may be construed by the public as an agent authorized to sell the goods in the shop and even if the person was not so authorized but did sell, the buyer will have a good case on the ground that the person was an agent by implication.

3. Agency of Necessity: With reference to the creation of an agency, a situation frequently arises where a person is entrusted, under an *emergency*, with property belonging to another and something has to be done for its preservation during the interval before communication with the legitimate owner. The person so entrusted with this property is called in law an “agent of necessity” and gets an implied authority to do what is necessary to save the property.

The Contract Act clearly states, “An agent has authority, in an emergency, to do all such acts for the purpose of protecting his principal from loss as would be done by a person of ordinary prudence, in his own case, under similar circumstances (S. 189).

ILLUSTRATION

An agent for sale may have the goods repaired if necessary; or where, say, *A* has consigned provisions to *B* at Calcutta, with directions to send them immedi-

¹ *Ball v. Dunsterville* (1971), 4 T.R. 313.

ately to C at Cuttack, B may sell the provisions at Calcutta if they will not bear the journey to Cuttack without spoiling [ills. (a) & (b) to S. 189].

We have also seen in the case of a wife who through no fault of hers has been forced to live apart from her husband, that she can pledge her husband's credit for all necessities of life according to the position of the husband. Here the pledging of credit is created by *Common Law* through an agency of necessity having been created. Here it should be noted that in *England* recently by the Matrimonial Proceedings and Property Act, 1970 Section 41 (1), the legal rules relating to a wife's agency of necessity have been removed from August 1, 1970 ("Any rule of law or equity conferring on a wife authority as agent of necessity of her husband, to pledge his credit or to borrow money on his credit is hereby abolished"). Yet another case is where a ship is in distress and the captain cannot communicate with the ship owner or cargo owner, he is empowered to pledge the ship owner's or cargo owner's credit and borrow money with a view to meet the expenses of repairing the ship or of preserving the cargo while on the voyage.

4. **Agency by Estoppel:** If a person by words or by conduct holds out another person as his agent to make contracts on his behalf, he will be bound by contracts made by such person on his behalf though he may not be in fact an agent. This is because the rule of estoppel applies and he is stopped or prevented from denying the truth of the fact which he at one time asserted and on the belief of which assertion a third party has altered his position. A person who is not an agent may be so held out to be; or a person who is an agent may be held out as authorized to do much more than his authority warrants, or a person who has ceased to be an agent may be held out as still continuing as one.

5. **Agency by Ratification:** Ratification is defined by the Contract Act, as "Where acts are done by one person on behalf of another, but without his knowledge or authority he may elect to ratify or to disown such acts. If he ratifies them, the same effects will follow as if they had been performed by this authority" (S. 96). "In Common Law this is a special type of agency known as 'agency by ratification'".

The doctrine of ratification is a famous doctrine of English law which has been the subject of interpretation by many eminent English judges. According to Tindal C.J. in *Wilson v. Fumman*,² "That an act done for another, by a person not assuming to act for

² (1843). 6 M. and G. 236.

himself but for such other person though without any precedent authority whatever, becomes the act of the principal, if subsequently ratified by him is the known and well-established rule of law. In that case the principal is bound by the act, whether it be founded on a tort or on a contract, to the same effect as by, and with all consequences which follow, the same act done by his previous authority." *The person who has the right to ratify is the person in whose name or on whose behalf the contract was entered into. A person cannot ratify an act unless it was purported to be done on his behalf.*

Ratification may be of one act or of a series of acts. *Every act may be ratified if it be not void in its inception, as long as it is capable of being done by the principal himself.* A voidable act may be the principal element in connection with ratification, but the *person must have acted "on behalf of another" and not on his own behalf*, and if it turns out that the person on whose behalf he presumed to act had given him no authority whatever, or that such a person's authority was exceeded then such an act may be ratified by the assumed principal in the first case, and by the principal whose authority was exceeded in the second. The ratification when made would have a *retrospective effect* and would relate back from the date when the act was committed. There are, however, *acts which cannot be ratified, i.e., criminal or illegal acts e.g., a forged signature.* Also in the case of a joint-stock company when certain acts are done by supposed agents, these acts can only be ratified by the company if they come within the objects clause as the memorandum of association, otherwise they cannot be ratified by the company which has no power to do the act itself.

Another condition to ratification is that *the principal claiming the ratification must have been in existence on the day the act sought to be ratified was done e.g., a company after incorporation cannot ratify an act done by its promoter on its behalf before incorporation as the company was not in existence when the act was done.*

The ratification may be *express or implied* in the conduct of the person on whose behalf the act are done (S.197).

ILLUSTRATIONS

(a) *A, without authority, buys goods for B. Afterwards B sells them to C, on his own account. B's conduct implies a ratification of the purchase made for him by A.*

(b) *A, without B's authority lends B's money to C. Afterwards B accepts interest on the money from C. B's conduct implies a ratification of the loan (ills. to S. 197).*

A person whose *knowledge* of the fact of the case is *materially defective* cannot make a valid ratification (S.198). *The ratification must be of the whole act* and cannot be of a part, and therefore, a person who ratifies an unauthorized act done on his behalf, ratifies the whole of the transaction of which such act forms a part (S. 199).

If an act is done by one person on behalf of another, without such other person's authority, which if done with authority would have the effect of subjecting a third person to damages, or terminating any right or interest of a third person, it cannot by ratification be made to have such effect (S.200).

ILLUSTRATIONS

(a) *A*, not being authorized thereto by *B*, demands on behalf of *B* the delivery of a chattel, the property of *B*, from *C*, who is in possession of it. This demand cannot be ratified by *B*, so as to make *C* liable for damages for his refusal to deliver.

(b) *A* holds a lease from *B*, terminable on three months' notice. *C*, unauthorized by *B*, gives notice of termination to *A*. The notice cannot be ratified by *B*, so as to be binding on *A*.

Ratification should be made *within a reasonable time*. It may be that the time is fixed by the nature of the particular case; *e.g.*, the exercise of an option by an authorized agent should be ratified within the time in which the option was to be exercised. Besides this the ratification ought to be clear, *i.e.*, a specific adoptive act of the person ratifying who should make it clear that he ratifies, or the ratification may be by acquiescence; *e.g.*, the receipt of purchase money was in one case held to be sufficient evidence of the ratification of sale by an unauthorized agent. Where the contract is ratified, the unauthorized agent or the agent who has exceeded his authority, is relieved from general liability to his principal for exceeding his authority, and may even recover his commission and expenses.

Different Classes of Agents

An agent may be (1) special, (2) general, or (3) universal.

(1) A *special* agent is one who is authorized to do a particular act on behalf of his principal *i.e.*, to go and buy a particular article or to sign a particular document for his principal.

(2) An agent is said to be *general* where he is authorized to do each and every lawful act which may be necessary to enable him to carry out his agency; *e.g.*, the manager of a branch office would be a general agent to do all that is necessary to carry on the branch business.

(3) A *universal* agent, however, possesses unlimited authority and therefore can act for his principal on all lawful matters.

It will thus be noticed that it is absolutely necessary while dealing with an agent to know the exact nature and scope of his authority, in order to ascertain whether the agent has the authority claimed by him; otherwise the principal will not be liable on the agent's contracts entered into by him in excess of his authority. A signature *per pro* is considered a sufficient warning to all who are called upon to accept it, that the agent signs by virtue of a power which may be either limited, or very wide, and it is therefore the duty of the person accepting such a signature, as the signature of the principal, to ask for the production of the power of attorney with a view to satisfy himself as to whether the agent has the authority claimed by him.

Husband and Wife

In the case of a *married woman living with her husband*, she is supposed to have an *implied authority to incur debts on behalf of her husband* with regard to *household necessities*; in the course of her management of the household, but the authority may be terminated either by the husband giving the wife a special separate allowance, or by the wife leaving the protection of her husband of her own accord.

Thus according to *Bowstead on Agency*

“Where a wife occupies the position of her husband's house-keeper, he is deemed to hold her out to the world as having the usual authority of a house-keeper, and is bound by all acts within the scope of such apparent authority unless the persons dealing with her knew that her authority is expressly limited and that she is acting in excess thereof.”

As we have seen already, in Indian Law a wife may be an *agent of necessity* to pledge her husband's credit for necessities of life supplied to her in case her husband has neglected to provide for her.

In all other cases, the position of a married woman as her husband's agent is exactly the same as that of any other person as her husband's agent. Thus if a husband by his conduct *induces* tradesmen to deal with his wife he is liable to them. Again, if a husband *ratifies* contracts which his wife has entered into without his authority, he holds her out as his agent and he will be liable in future to outsiders who deal with the wife relying on such implied

authority, even though he may have subsequently expressly revoked her authority to bind him without notifying the persons dealing with her.

The same principle would apply to a Hindu, Parsi or European wife, and it has been held in one case that a Hindu wife who lives separate from her husband, because the husband has married a second wife, has no implied authority to borrow money for her separate maintenance, as in Hindu Law second marriage does not justify separation.⁸ However, if a married woman contracts debts in connection with her separate estate, independently of her husband, she will not be considered to have acted as the agent of her husband, under any circumstances.

Mercantile Agents

The special classes of mercantile agents one comes across are the following:

(1) A *factor* is defined as an agent “employed to sell goods or merchandise consigned or delivered to him by or for his principal for a compensation” (*Storey on Agency*, S. 33).

(2) A *broker* is defined by the same authority to be “an agent employed to make bargains and contracts in matters of trade, commerce or navigation, between two parties for a compensation commonly called brokerage”.

It may be added here that the *difference between a factor and a broker* is that in the case of a factor he has the possession of the goods whereas a broker has not. A factor generally sells goods in his own name, but a broker generally has not that authority. A factor receives payment and gives valid receipts, and having the possession of the goods he has an insurable interest in them. For the same reason, he has a lien on these goods for the charges that may be due to him. A factor makes advances on the goods in his possession. A broker, on the other hand, is only an agent for the purposes of sale or purchase, on behalf of his principal, and when he enters into a contract he enters the terms of his purchase or sale in his *memorandum book*. He then makes out a “*Bought Note*” and “*Sold Note*”—which must be written in identical terms—signs and sends them to the buyer and seller respectively, which notes, if they agree, will constitute evidence of the agreement between the buyer and the seller. Should the bought and sold notes differ, the entry in

⁸ *Nathubhai v. Javher* (1876) 1 Bom.121, 122.

the broker's book would constitute the contract.⁴ The broker, when authorized to sell or buy, has an implied authority to act on the usages of the market concerned and bind his principal unless such usages are unreasonable or unlawful.⁵ A broker is not liable on the contracts he enters into as a broker even though the name of his principal is not disclosed in the contract note.⁶ A custom of the market may, however, make him liable. A further point to be noted in the case of a factor is that when a factor has made advances and his security is impaired by a fall of the market or any other cause he is invested with a power of sale after due notice to his principal if the principal does not put the factor in funds to make up the deficit.⁷

There are various types of brokers and one of the most important types one come across in the mercantile world is the *stock broker*. The stock broker is generally a member of the local Stock Exchange. On all exchanges in India, the broker is employed by the client to buy or sell and carries out the bargain by approaching another broker member of the Stock Exchange. The rules of the Stock Exchange make it compulsory for selling as well as buying brokers to be prepared to give delivery of the stock bought or sold, on payment, according to their contracts. When a person engages a stock broker, or any broker who happens to be a member of a market or exchange like the Stock Exchange or Cotton Exchange, the principal who engages him will be presumed to have given him the authority to enter into this contract in compliance with the rules and regulations of his market, and thus all the reasonable customs and rules of the markets concerned which are binding on the broker are also binding upon his principal, whether the principal is aware of them or not. It is usual among brokers to put through transactions in connection with a particular share or stock on behalf of several clients in one transaction and then to split them in his own book, dividing them into as many separate transactions as there are clients for whom he entered into them. This custom has been recognized as binding on the principal by the custom of the Stock Exchange.⁸

(3) *Bankers* are agents of their customers to pay sums of money on their behalf as ordered by them, to purchase and sell securities,

⁴ *Southwell v. Bowditch* (1876), I.C.P.D. 374

⁵ *Cropper v. Cook* (1868), L.R. 3 C.P. 194

⁶ *Southwell v. Bowditch* (1876,) I.C.P.D. 374

⁷ *Jafferbhai L. Chatto v. Thomas D. Charlesworth* 17 Bom. 520

⁸ *Scott v. Godfrey* (1902), 2 K.B. 726

collect interest and dividend on them and act as custodians of their securities and valuables on behalf of their customers; they also collect cheques and bills of exchange on their customers' behalf and render numerous other services to their customers as agents.

(4) *An auctioneer* is defined by Storey as "a person authorized to sell goods or merchandise at a public auction or sale for a recompense" (*Storey on Agency*, S. 27). He may be an agent for both seller and buyer, and may or may not be entrusted with the possession of the goods or property to be sold, or of documents or title deeds. Generally speaking, he is the *agent of the seller*, and therefore can do all such acts as may be necessary in order to auction the goods, but when the goods have been knocked down to the highest bidder, he becomes an *agent for the buyer also*. Thus when he makes an entry in his book, relating to a sale and signs it, it binds both the buyer and the seller. It must be noted, however, that an auctioneer's clerk has not that authority.⁹ Besides this, an auctioneer is expected to sell for cash, otherwise he would have to make good the losses suffered through his having delivered goods on credit. He has an implied authority to receive money against the goods, but with regard to the sale of land he can receive the deposit only, unless expressly authorized to receive the full amount. An authority to sell by auction does not imply any authority to sell by private contract even if the auctioneer is offered a higher price than the reserve.

When an auction sale is advertised, it is not to be taken as an agreement to hold the sale, with the result that if the sale does not take place the auctioneer cannot be sued for damages by persons who attend the sale on the ground that their time was wasted or that they incurred expenses in coming to the sale.¹⁰

Dutch auction is one in which the auctioneer himself offers the article at a price and then gradually reduces it until a buyer is found to accept the article at a price.

(5) *A commission agent* is generally an agent who acts on behalf of a foreign principal and earns his commission for his labour. He differs from a broker in so far as the authority to establish the privity of contract between his employer and third persons is concerned. He only buys on behalf of his employer in his own name and receives a commission for his trouble.

⁹ *Bell v. Balls* (1897), 1 Ch. 663

¹⁰ *Harris v. Nickerson* (1873), 8 Q.B. 286

If frequently happens that a commission agent, when he buys goods for a foreign principal, gives to the seller an acceptance price and is personally liable for the payment of the price. But in case the principal fails to pay the seller, and the agent has to make good the amount, he can sue his principal for indemnity but not as for goods sold and delivered. It has also been held that a commission agent for a foreign principal has no implied authority to pledge his principal's authority.

(6) A "*del credere agent*" is one who in consideration of an extra commission, agrees to indemnify the principal against losses arising from the failure of a person with whom he contracts on behalf of his principal. In other words, the agent here gives an undertaking that nothing shall be lost by his principal through the failure of a third party. The *del credere* agency arrangement may be either express, or implied from the fact that the agent was charging an additional commission for the risk.

Counsel, Attorney and Pleader

Though these cannot be classed among mercantile agents they are always engaged by merchants to conduct their suits in connection with mercantile disputes. The relationship of principal and agent exists between a client and his attorney or pleader but not in the case of a counsel.¹¹ Yet in the case of a *counsel* his authority at the trial, unless limited, relates to the trial and all matters incidental to it and to the conduct of the trial.¹² This includes the power to compromise a case on behalf of his client unless his authority to act for his client is revoked and the other party is notified of this fact.¹³ An *attorney* has a similar authority and can compromise his client's suit unless his client has given express direction to the contrary. A *pleader*, on the contrary, must obtain his client's authority before entering into a compromise of the suit.

Sub-agent

A *sub-agent* is defined by Section 191 as "a person employed by, and acting under the control of, the original agent in the business of the agency".

With regard to the appointment of sub-agents, Section 190 clearly states that an agent cannot lawfully employ another to per-

¹¹ *Mathews v. Munster* (1887) 20 Q.B. Div. 141, 142

¹² *B. N. Sen v. Chunilal Dutt & Co.*, 50 Cal 385

¹³ *Nundo Lal v. Nistarini* (1900) 27 Cal. 428

form acts which he has expressly, or impliedly, undertaken to perform personally unless, by the *ordinary custom of trade*, a sub-agent may, or from the *nature of the agency*, a sub-agent must, be employed.

This rule (S. 190) is based upon the maxim of Roman Law, *viz. delegatus non potes delegare*, which lays down the general rule that an agent cannot delegate his powers to another in whole or in part without express authority from his principal.¹⁴ This is on the supposition, that when a person is appointed an agent, the person appointing does so because he has confidence in the person so appointed, and thus where it is proved that this was so, no delegation is permissible, however general the nature of the duty, except in the case of urgent necessity. To this rule, of course, there are well recognized exceptions *e.g.*, where the custom of trade permits such delegations, or where the nature of the business is such that it cannot be carried on without the appointment of sub-agents or where the principal acquiesced in the appointment of a sub-agent. In such cases a sub-agent is said to be properly appointed, and hence the principal is so far as regards third persons, represented by the sub-agent, and is bound by and responsible for his actions, as if he were an agent originally appointed by the principal. But, the agent is responsible to the principal for the actions of the sub-agent, and the sub-agent in his return is responsible for his actions to the agent, but not to the principal, except in cases of fraud or wilful wrong (S. 192).

Further, as a *sub-agent is not personally in contractual relationship with the principal*, he has to look to the agent for his remuneration.

If, however, an agent appoints a sub-agent without having authority to do so, such agent would be responsible for the sub-agent's actions both to the principal and to a third party. In such a case the sub-agent is said to be *improperly appointed*, and the principal himself, not being represented by the sub-agents, is not responsible for the acts of such person nor is such a person responsible to the principal (S. 193).

The Contract Act makes a *further distinction* in Section 194 and states that where an agent holding an express or implied authority to name another person to act for the principal in the business of an agency, has nominated another person accordingly, such person is not a sub-agent but an agent of the principal for such part of the business of the agency as is entrusted to him.

¹⁴ *De Bussche v. Alt* (1873), L. R. 8 Ch. D. 286

ILLUSTRATIONS

A directs *B*, his solicitor, to sell his estate by auction, and to employ an auctioneer for the purpose. *B* names *C*, an auctioneer, to conduct the sale. *C* is not a sub-agent, but is *A*'s agent for the conduct of the sale.

Similarly, *A* authorises *B*, a merchant in Calcutta, to recover the money due to *A* from *C*, and *B* instructs his solicitor *D* to take legal proceedings against *C* for the recovery of the money. *D* is not a sub-agent but is a solicitor for *A*.

This is because a person so nominated is not an ordinary sub-agent, but a *substituted agent* between whom and the principal there is direct privity of contract. It is, however, further specified that, if in this case the agent names or selects the other person for his principal, he is bound to exercise the same amount of discretion as a man of ordinary prudence would exercise in his own case; and if he does that he would not be responsible to the principal for the acts of negligence of the agent so selected (S. 195).

ILLUSTRATION

A instructs *B*, a merchant, to buy a ship for him. *B* employs a ship surveyor of good reputation to choose a ship for *A*. The surveyor makes the choice negligently and the ship turns out to be unseaworthy and is lost. *B* is not, but the surveyor is responsible to *A*. Similarly, *A* consigns goods to *B*, a merchant, for sale. *B*, in due course, employs an auctioneer in good credit to sell the goods of *A* and allows the auctioneer to receive the proceeds of the sale. The auctioneer afterwards becomes insolvent without having accounted for the proceeds. *B* is not responsible to *A* for the proceeds (Ills. to S. 195)

TERMINATION OF AGENTS' AUTHORITY

An agent's authority terminates by—

- (1) revocation by the principal;
- (2) renunciation by the agent;
- (3) completion of the business of the agency;
- (4) death or insanity of the principal or the agent;
- (5) adjudication in insolvency of the principal (S. 201);
- (6) effluxion of time;
- (7) destruction of the subject-matter; or
- (8) agreement of the parties.

Termination under (1), (2) and (3) is known as termination by the act of parties whereas the rest is known as termination through the operation of law.

When an agent's authority is terminated, the authority of all sub-agents appointed by him also comes to an end (S. 210).

(1) & (2) Revocation by the Principal or Agent

With regard to the principal's right to terminate the authority, Section 202 lays down that "Where the agent has himself an interest in the property which forms the subject-matter of the agency, the agency cannot in the absence of an express contract, be terminated to the prejudice of such interest"

ILLUSTRATION

A gives authority to *B* to sell *A*'s land, and to pay himself out of the proceeds the debts due to him from *A*. *A* cannot revoke this authority, nor can it be terminated by his insanity or death. Similarly, *A* consigns 1,000 bales of cotton to *B*, who has made advances to him on such cotton and desires *B* to sell the cotton, and to repay himself, out of the price, the amount of his own advances. *A* cannot revoke this authority, nor is it terminated by his insanity or death (ills. to S. 202).

This is called "authority coupled with interest". The principle here involved is that an agency is not revocable in the case of an agreement for a valuable consideration where an authority is given with a view that the agent may secure a particular benefit.

In this connection it may be said that in the case of a factor though his authority can be revoked at any time, even though he may have made advances, still if the principal has authorized the agent to sell the goods and to pay himself out of the proceeds against his advances he falls under Section 202 and becomes an agent having a personal interest in the property and thus the principal in such cases cannot revoke his authority. There is, however, no objection to the authority of the agent being revoked or terminated by agreement between the principal and the agent or by either side giving notice to that effect.

The principal may, save as provided for by Section 202, revoke the authority given to his agent at any time before the authority has been exercised so as to bind the principal (S. 203). For example, an authority given to an auctioneer to sell the goods may be revoked at any time before the goods are knocked down to the highest bidder. But where the authority given to the agent has been partly exercised, it cannot be revoked so far as regard such acts and obligations as arise from acts already done in the agency.

ILLUSTRATION

A authorizes *B* to buy 1,000 bales of cotton on account of *A* and to pay for it out of *A*'s money remaining in *B*'s hands. *B* buys 1,000 bales of cotton in his own name, so as to make himself personally liable for the price. *A* cannot revoke *B*'s authority so far as regards payment for this cotton (S. 204).

But if the authority has been given for any period of time either expressly or by implication the principal must make compensation to the agent or the agent to the principal, as the case may be, for any previous revocation or renunciation of the agency without sufficient cause (S. 205).

Reasonable notice must be given of the revocation or renunciation otherwise the principal or agent as the case may be, who fails to give such notice will be liable for any resultant damage (S. 206). Revocation and renunciation may be express or implied from conduct (S. 207).

The termination of the agency takes effect from the time the agent is informed of it, and so far as third parties are concerned it only terminates after it becomes known to them (S. 208). Even after termination of agency by the death of the principal or the principal becoming of unsound mind the agent is bound to take, on behalf of the representatives of his late principal, all reasonable steps for the protection and preservation of the interests entrusted to him (S. 209).

(3) Completion of Business of the Agency

This occurs when an agent who is employed to do a particular work completes it; *e.g.* a broker employed to procure a buyer for a particular house or motor car procures one and is accepted by his principal, that particular agency is terminated from the moment of the completion of that transaction.

(4) By Death or Insanity

The death or insanity of the principal or agent brings about an end to the agency (S. 201). Where the agency is terminated by the death or insanity of the principal, the agent is bound to take all reasonable steps for protecting and preserving the interests entrusted to him, on behalf of the representatives.

(5) By Adjudication in Insolvency

The adjudication in insolvency of the principal puts an end to the agent's authority (S. 201). The termination of agency by death, insanity or insolvency is a termination by operation of law

(6) Effluxion of Time

If the period during which the agency was agreed to continue terminates, the agency naturally is determined, unless by an express or implied agreement of the parties it is further continued.

(7) Destruction of Subject-matter

If the subject matter for which the agency contract was originally entered into, say an agency for a particular steamer or for the use of a particular theatre, is destroyed, the agency naturally comes to an end.

(8) Agreement of Parties

It is easy to understand that agreement between parties can terminate all agencies even before the effluxion of time.

AGENT'S DUTIES

The duties of an agent to his principal may be briefly put down under the headings of (1) obedience, (2) skill and diligence, (3) rendering of accounts, (4) emergency, and (5) fidelity.

(1) Obedience

With regard to the first, an agent is bound to conduct the business of the *agency according to the directions* given to him by his principal, or in the absence of any such directions, according to the custom of trade which prevails at the place where the agent conducts such business; otherwise the agent would have to make good losses, if any, sustained by his principal, but if any profits are made that would belong to his principal (S. 211). This rule must be strictly followed and under no circumstances, even if he thinks it is for the benefit of the principal can he act contrary to his principal's express instructions, because if he does so the benefit arising, as we have seen, will go to the principal but the loss will fall wholly on him. The agent is strictly bound to obey his principal as far as the principal's instructions are lawful. *In the absence of instructions from the principal, he has to act according to the customs of trade prevailing,* as we have seen above.

ILLUSTRATION

If an agent has been instructed to keep the principal's money in a particular bank and the agent deposits it in some other bank, the agent will have to make good the loss in case the latter bank fails and the money is lost. Similarly, if an agent who is engaged to carry on *B's* business in which it is the custom to invest from time to time, at interest the moneys which may be in hand, omits to make such investment he will have to make good to *B* the interest usually obtained by such investments. Again if *B*, a broker, in whose business it is not the custom to sell on credit sells goods of *A* on credit to *C*, whose credit at the time was very high and then before payment *C*, becomes insolvent *B* will have to make good the loss to *A*.

(2) Skill and Diligence

With regard to the second part, the agent employed to do the work is expected to do it with *reasonable skill and diligence*, i.e. with such skill and diligence as a prudent man who claims to be possessed of such skill would exercise while acting with regard to his own affairs of a similar character. If an agent is particularly appointed on account of his special skill as an expert then he must show expert skill and act according to the stand which is expected of men in that particular profession, e.g. a lawyer who is appointed to conduct a suit cannot say to his client. "I did not know the law on that particular point" and hold that out as an excuse. Our Act does not make the distinction between a paid and gratuitous agent as exists in English Law. In the language of the Contract Act, "An agent is bound to conduct the business of his agency with as much skill as is generally possessed by persons engaged in a similar business, unless the principal has notice of his want of skill. The agent is always bound to act with reasonable diligence, and to use such skill as he possesses and to make compensation to his principal in respect of the direct consequences of his own neglect, want of skill or misconduct, but not in respect of loss or damage which is indirectly or remotely caused by such neglect, want of skill or misconduct" (S. 212).

ILLUSTRATION

A, an insurance broker employed by B to effect an insurance on a ship, omits to see that the usual clauses are inserted in the policy. The ship is afterwards lost. In consequence of the omission of the clauses nothing can be recovered from the underwriters. A is bound to make good the loss to B [illus. (c) to S. 212].

(2) Accounts

An agent is bound to *render proper accounts* to his principal *on demand* (S.213). It is one of the important duties thrown on the agent that he must keep proper accounts and produce them with vouchers and receipts whenever the principal desires their production. Any delay on his part will make him liable to pay interest and other expenses. What is expected of the agent is not only to produce accounts but also to come and explain them personally if required. An agent who has not kept proper accounts is likely to have the presumption against him on all consistent and established facts.

It is an *implied contract* between a principal and his factor or agent that the latter will render accounts on demand from the former.

(4) Emergency

It is a further duty of the agent to communicate with the principal in cases of emergency and as far as possible to ask for instructions in the matter (S. 214).

(5) Fidelity

In this case the agent is bound *to act honestly to disclose* to his principal *all material facts known to him*. If the agent, in the course of the agency, personally buys from or sells to his principal goods he is asked to sell or buy on account of his master, without obtaining the principal's consent, or without letting him know of the fact that he is himself the purchaser or seller of goods, or without acquainting him with all the material facts which may have come to his knowledge on the subject, *the principal may repudiate the transaction* where it can be shown that any *material fact has been knowingly concealed* from the principal by the agent, or that the *dealings of the agent have been disadvantageous to the principal* (S. 215) e.g. *B* an agent, employed by *A* to sell an estate, buys the estate for himself in the name of *C*. *A*, on discovering that *B* has bought the estate for himself, may repudiate the sale, if he can show that *B* has dishonestly concealed any material fact, or that the sale has been disadvantageous to him. This rule is based upon *the principle* that when an agent is asked to sell, he must try and obtain the best possible price for his principal, and therefore, if he himself becomes the buyer without disclosing the fact to the principal, or without obtaining his consent, he cannot be said to have acted in good faith nor to have obtained the highest price for his principal because his interests in such circumstances would clash with those of the principal. Again, if an agent, without the knowledge of his principal, deals on his own account in the business of the agency, *the principal is entitled to claim from the agent any benefit* which the agent may have derived from the transaction (S. 216). The agent is entitled to nothing more than his lawful remuneration and all the profits made and advantages gained by him in such transactions beyond his legitimate remuneration must go to the principal.¹⁶ The agent here is acting in a *fiduciary capacity* so that he is bound to disclose fully his intention and *must account for all secret profits* made by him. The agent who has thus wrongly dealt on his own account is *not entitled* to any commission on such a transaction. Thus an agent may not make any profit apart from his agreed remuneration unless his principal both knows and consents.

¹⁶ *Morison v. Thompson* (1874) L.R. 9 Q. B. 480

If the *principal* discovers that the agent has received payment by way of *bribe* he is entitled to (1) repudiate the contract made by the corrupt agent, (2) *dismiss* his agent without notice, (3) *forfeit* any commission in respect of the transaction which the agent may have earned, (4) *recover* any money he may have received by way of profit, with interest at 5 per cent per annum from the date of receipt of such payment to the last date of such payment, and (5) *sue the third party for damages* sustained through such bribery.

It may be added here that in *England* they have an Act known as *The Prevention of Corruption Act 1906* under which both the agent as well as the person paying the bribe are guilty of a criminal offence. We have *no such Act in India*. The only condition in English Law is that before the party can be prosecuted the consent of the Attorney-General or the Solicitor-General should be obtained.

Rights of an Agent against his Principal

An agent has the right to *retain*, out of the sum received on account of his principal, *all moneys due to himself* in respect of *advances* made or *expenses properly incurred* by him in conducting the business of the agency and also the remuneration payable to him for acting as such agent and to *repay the balance* to the principal (Ss. 217 & 218).

This will include the right to recover from the principal all money paid by the agent as such on behalf of the principal, either at the latter's request, or under the implied understanding arising from the nature of the agency, or through the custom of the market where the agent is instructed to transact business on behalf of his principal. Thus it has been *held* that a person who employs a broker on the Stock Exchange, impliedly authorizes him to act according to the rules and usages of the Exchange as far as they are reasonable and legal.

The *remuneration* of an agent for the performance of any act does not become due until the completion of such act, but he may retain moneys received by him on account of goods sold although the whole of the goods consigned to him for sale may not have been sold or although the sale may not be actually complete (S. 219).

Of course, if he has misconducted the business *he has no right of remuneration in connection with that part of the work which he has misconducted*. Otherwise with regard to his lawful remuneration he has, subject to any agreement to the contrary, a right of retention

against goods, papers and other property of the principal, whether movable or immovable, that happen to have come in his possession in the course of agency transactions until the money due to him for commission, disbursements and services in respect of the same has been paid or accounted for to him (S. 221). This is the *particular* lien of an agent.

PRINCIPAL'S DUTIES

The Principal is bound to *indemnify* his agent against the consequences of all lawful acts done by such agent in the exercise of the authority conferred upon him.

ILLUSTRATIONS

(a) *B* at Singapore, under instructions from *A* of Calcutta, contracts with *C* to deliver certain goods to him. *A* does not send the goods to *B* and *C* sues *B* for breach of contract. *B* informs *A* of the suit, and *A* authorizes him to defend the suit. *B* defends the suit and is compelled to pay damages and costs, and incurs expenses. *A* is liable to *B* for such damages, costs and expenses.

(b) *B*, a broker at Calcutta, by the orders of *A*, a merchant there, contracts with *C* for the purchase of 10 casks of oil for *A*. Afterwards *A* refuses to receive the oil, and *C* sues *B*, *B* informs *A*, who repudiates the contract altogether. *B* defends, but unsuccessfully and has to pay damages and costs and incurs expenses. *A* is liable to *B* for such damages, costs and expenses (illus to S. 222).

The principal is also responsible to make good the losses and liabilities that may have been incurred by the agent on behalf of the principal while acting in the exercise of his authority arising through the rules and customs of a particular trade or market in which the agent was authorized to deal, provided the rule or custom is reasonable and the principal had notice of it.

The principal is also liable for any act done by the agent in good faith in case such act causes any injury to the rights of a third person and against all consequences of that act. Section 223 says,

“Where one person employs another to do an act and the agent does the act in good faith the employer is liable to indemnify the agent against the consequences of this act though it causes an injury to the rights of third persons.”

ILLUSTRATION

B, at the request of *A*, sells goods in the possession of *A*, but which *A* had no right to dispose of. *B* does not know this, and hands over the proceeds of the sale to *A*. Afterwards *C*, the true owner of the goods sues *B* and recovers the value of

the goods and costs. *A* is liable to indemnify *B* for what he has been compelled to pay to *C* and for *B*'s own expenses [S. 223 & illus. (b)].

With regard to the above it must be noted that if the agent was employed to do a criminal act he has no right of indemnity against his principal for the consequences of such an act (S. 224).

ILLUSTRATION

A employs *B* to beat *C*, and agrees to indemnify him against all consequences of the act. *B* thereupon beats *C* and has to pay damages to *C* for so doing. *A* is not liable to indemnify *B* for those damages (illus. (a) to S. 224).

If any loss is caused to the agent through the principal's neglect or want of skill, the principal is in his turn bound to make compensation to his agent for such loss (S. 224).

ILLUSTRATION

A employs *B* as a bricklayer in building a house and puts up the scaffolding himself. The scaffolding is unskilfully put up, and *B* is in consequence, hurt. *A* must make compensation to *B* (illus. to S. 225).

Effect of Agency on Contract with Third Persons

Where a principal has given authority to his agent and the agent acts under that authority, all contracts entered into through that agent are binding on the principal and the obligations arising therefrom may be enforced against the principal as if he had himself entered into them (S. 226). This rule will apply even where the agent enters into a contract in furtherance of his own interest and contrary to the interest of his principal, as long as the third party while dealing with the agent acted in good faith.

If the agent exceeds his authority and does more than he is authorized to do, the rule is that where that part which is within his authority, can be separated from that which is beyond his authority, so much only of what he did as was within his authority is binding between him and his principal. As far as the third party is concerned, the principal cannot escape liability if that act falls within the apparent scope of authority of the agent. If, however, the act done falls outside the apparent scope of the agent's authority the principal will not be bound by such act under any circumstances (S. 227).

ILLUSTRATION

A being owner of a ship and cargo, authorises *B* to procure an insurance for 4,000 rupees on the ship. *B* procures a policy for 4,000 rupees on the ship and

another for the like sum on the cargo. *A* is bound to pay the premium for the policy on the ship, but not the premium for the policy on the cargo (illus. to S.227)

But if that which is within the scope of the authority of the agent cannot be separated from that which is beyond that scope, the principal is not bound to recognise the transaction.

ILLUSTRATION

A authorises *B* to buy 500 sheep for him. *B* buys 500 sheep and 200 lambs for the sum of Rs 6,000. *A* may repudiate the whole transaction (S. 228).

It may, however, happen that by the usage of a particular market or trade the agent may be personally liable either to his own principal or to a third party, where he has not disclosed his principal at the time of the contract.

Notice or information given to the agent in the regular course of the business transaction by him for the principal shall, as between the principal and third parties, be a notice to the principal (S. 229).

A is employed by *B* to buy from *C* certain goods of which *C* is the apparent owner, and buys them accordingly. In the course of the treaty for the sale *A* learns that the goods really belonged to *D* but *B* is ignorant of that fact. *B* is not entitled to set off a debt owing to him from *C* against the price of the goods (illus. (a) to S. 229). This rule does not apply where the agent who has notice is himself a party to the commission of a fraud on the principal in connection with the transaction of which he had notice. The agent who is himself a party to the fraud is not supposed to communicate the fraud to the principal who is the defrauded party and, therefore, in such a case, a notice to the agent cannot be taken as a sufficient notice to his principal.¹⁶

When Agent is Personally Liable on Contracts

As we have seen above, contracts properly entered into by an agent on behalf of the principal are binding on the principal personally, and therefore, the principal himself can enforce such contracts. The agent cannot personally enforce such contracts entered into by him on behalf of his principal, nor would he be personally liable on such contracts unless there is an agreement to that effect. There are, however, the following exceptions to this rule where it is presumed that unless a contract to the contrary exists the agent would be personally bound.

- (1) Where the contract is made by an agent for the sale or purchase of goods for a merchant residing abroad.
- (2) Where the agent does not disclose the name of his principal.
- (3) Where the principal, though disclosed, cannot be sued (S. 230).

¹⁶ *Harmasji v. Mankuverbai*, 12 B.H.C. 262

In all the above cases *the ground* on which the agent is presumed to be personally liable is that the credit was given by the third party to the agent in person.

Foreign Principal

It has been held in English courts that an agent for a foreign principal has *Presumptively* no authority to pledge the credit of the foreign principal. The agent may, however, protect himself by clearly making the contract in the name of his principal and without recourse to himself.

With regard to a foreign principal it may be added that the right of the third party to sue the principal is not lost by the presumption contained in Section 230. If there is a writing in which a foreign principal is made a contracting party, the foreign principal would be personally liable.

Undisclosed Principal

In the case of contracts on behalf of an undisclosed principal, the credit would be taken to have been given to the agent by the third party who relied solely on the credit of the agent while dealing with him on behalf of the undisclosed principal. If, however, it can be shown that the third party knew the name of the undisclosed principal, and the principal was made personally liable, the presumption making the agent personally liable will be rebutted, Chief Justice Lord Tenterdon lays down in *Thomson v. Davenport*¹⁷ that "If a person sells goods (supposing at the time of the contract that he is dealing with a principal) but afterwards discovers that the persons with whom he has been dealing is not the principal in the transaction, but agent for a third person, though he may in the meantime have debited the agent with it, he may afterwards recover the amount from the real principal". In short, the *general rule* is that where an agent deals with a third party without disclosing the fact that he is an agent and afterwards it is clear that he was only acting as an agent and not on his own account, the third party would have the option either to sue the agent or the principal. If, however, the third party knew that the person acting was an agent, but the name of the principal was not disclosed, *i.e.*, the principal was unnamed, the agent would not be personally liable except where the usage or custom of trade made him liable.

¹⁷ (1829), 9 B. and C., p. 86.

Indian Rule re: Undisclosed Principal

The Indian rule with regard to an undisclosed principal is clearly laid down in Section 231 as, "If an agent makes a contract with a person who neither knows, nor has reason to suspect, that he is an agent, his principal may require the performance of the contract; but the other contracting party has, as against the principal the same rights as he would have had against the agent if the agent had been principal". It is, however, open to the other contracting party to refuse to fulfil the contract if the principal discloses himself before the contract is completed. This can be done by the third party on the ground that he did not know that there was an undisclosed principal, because if he had known, he would not have entered into the contract.

Thus *the Indian law rule is even stronger than that of English Law*, because here the mere non-disclosure of the principal's name is not sufficient. The third party ought also to be prepared to show that he neither knew *nor had reason to suspect* that there was an undisclosed principal. Further, "Where a person who has made a contract with an agent induces the agent to act upon the belief that the principal only will be held liable, or induces the principal to act upon the belief that the agent only will be held liable, he cannot afterwards hold liable the agent or the principal respectively" (S. 234). It should be further noted that it has been laid down in England that when a person signs a contract for another as agent, he is to be taken to contract as agent and is not personally liable even though in the body of the contract he purports to be the principal.¹⁸

We have seen that a person untruly representing himself as the agent of another is liable to be sued for compensation by the third party with whom he enters into a contract under such false representation, if the principal does not ratify the contract but what is more, the agent cannot enforce the performance of the contract on the third party. This rule is opposed to that of *English Law* where the agent can enforce performance of such a contract (Ss. 235 & 236).

Agent's Signature on a Bill of Lading

Again, in the case of a bill of lading, an agent who has authority to sign on behalf of his principal *must sign it as agent* and make that fact clear in his signature. If the agent signs this document in his own name, he cannot render his principal liable thereon, except as under Section 28 of the Negotiable Instruments Act, i.e., where he was

¹⁸ *Universal S.N. Co. v. Mckelvie & Co.*, (1923), W.N. 146.

instructed to sign his own name upon the belief that the principal alone would be held liable, in which case this defence is available only against the person who so instructed him to sign.

Unauthorized Acts of Agents

Finally, if the agent has done anything, or incurred any obligation, without the authority of his principal, the principal will be bound by such act or obligations if he has by words or conduct induced the third party to believe that the agent had such authority (S. 237). All misrepresentations or frauds committed by agents while acting in the course of the business of the principal, have the same effect as if the misrepresentation or fraud had been made or committed by the principal himself. If, however, these misrepresentations or frauds were committed while acting beyond the scope of the agency the principal would not be bound by them.

Breach of Warranty of Authority

There is, however, a case where an agent exceeds the authority given to him or where he acts in connection with the business of the principal without authority from him express or implied, and here the principal of course is not bound until he ratifies as we have already seen. If, however, the *principal does not ratify* the contract the agent becomes liable to pay damages to the injured party because there was a breach by him of the warranty of authority which he gave to the third party and which induced the third party to enter into a contract with him.¹⁹ In other words, when a person represents that he is contracting as agent for a principal, in law he impliedly warrants to the other party that he has authority. If in fact the professed agent lacks authority and the third party suffers in consequence, the pretended agent may be sued for damages for breach of the implied authority. This kind of liability is incurred on the ground of *holding out* which is a special application of the principle of *estoppel*. Thus *the agent is liable to pay on the ground of breach of warranty of authority and not on the contract* because in case of a contract neither the principal nor the agent is liable. Here, however, it is presumed that the agent while he exceeded the authority or acted without authority honestly believed that he had authority. If, on the contrary, *he knew that he had no authority* and acted in spite of that knowledge, he would be liable in an action for deceit.²⁰

¹⁹ *Collen v. Wright* (1856) 7 E. & B. 301

²⁰ *Randall v. Trimen* (1856) L. J. C. P. 307

Misrepresentation by Agent

It should also be remembered that if an agent acting within the course of his authority commits fraud or misrepresentation, that would give *the opposite party a right to set aside the contract* the agent has entered into on behalf of his principal.

Torts of Agents

Any tort committed by the agent while *acting in the regular course of business* of his principal would make both the principal and the agent jointly and severally liable.²¹ For any tort committed by the agent *outside the scope of his authority* the principal of course is not liable.

THE ADAT SYSTEM

The Agency Law dealt with in this chapter is considerably modified by and applied in cases known as the *pukki and katchi Adatta* system. These systems have been carefully scrutinized by the High Court of Bombay in two leading cases and declared as *custom, not unreasonable and therefore enforceable and good*.²²

Pukki Adat

Under this system an upcountry constituent sends an order to a Pukka Adatia say, in Bombay to purchase or sell any particular commodity for future deliveries, the price being fixed by the negotiations. As soon as the bargain is closed, the *pukka Adatia* in Bombay is bound to deliver goods at that price on the dates fixed by the contract and failing that he pays the difference between the market price and the contract price. To put it briefly, the contract is to find the goods or to pay the difference. The *Pukka Adatia* has no authority to pledge the credit of the upcountry constituent to the merchant from whom he may buy these goods by a covering contract. In fact it is not at all objectionable to the nature of this type of transaction that the *Pukka Adatia* sells to the upcountry constituent without having in the first instance entered into such a covering contract. The *Pukka Adatia* is thus virtually a principal entering into an independent contract with the upcountry constituent. In case of the covering contract also (where one exists) he

²¹ *Betts v. Ditre* (1868), 3 Ch. 429

²² *Bhagwandas Narottamdas v. Kanji Deoji* (1906), 30 Bom. 259
Fakirchand Lalchand v. Doolub Govind, 7 Bo.n. L. R. 213

stands in the same relation to the Bombay merchants, in which covering contract of course the upcountry constituent has no privity.

It will thus be seen that the *Pukka Adatia* is not an agent at all in terms of the Agency Law.

Katchi Adat

Under this system the *Katcha Adatia* receives an order from the upcountry constituent for purchase or sale and sends for a broker to settle the rate. The broker who settles the rate guarantees to bring a party willing to buy or sell at that rate and as soon as that is done a regular contract is entered into between the third party and the *Adatia*. If, within the period intervening, the market rises above or falls below the rate so fixed, the profit in the former event goes to the broker on his securing the contract at a higher rate and in the latter case the loss arising through the fall of the market, has to be paid by the broker. The payment of the difference between the market rate and the original rate is known as *the broker's gala*.

Difference between Pukka and Katcha Adatia

Both the *Pukka Adatia* and the *Katcha Adatia* guarantee the performance of the contract they enter into but, whereas the *Pukka Adatia* guarantees it both to his own principal and to the third party the broker or shroff, the *Katcha Adatia* guarantees it only to the third party and not to his own principal. Moreover, a *Pukka Adatia* while carrying out his principal's instructions, is permitted by custom, to substitute his own contract instead of a contract with a third party.

Thus the *Pukka Adatia* is virtually a principal whereas the *Katcha Adatia* is purely an agent.

SUMMARY

Definition of Agent : The Indian Contract Act defines an agent as "a person employed to do any act for another or to represent another in dealings with third parties." (S. 182).

Considerations Not Necessary : No consideration is necessary to create an agency (S. 185).

Test of Agency : When a person can bind another by acts done on his behalf.

Who can Employ an Agent? Any person capable of being bound by a contract may appoint an agent, i.e. the principal must have contractual capacity.

Who May Be Appointed an Agent? As the agent is only an instrument through which the principal acts, therefore anyone, even a minor, may be appointed an agent.

Creation of Agency : No particular form is necessary to create an agency. It may be created in any of the following ways:—

(1) Expressly, *i.e.* by words spoken or written.

(2) Impliedly:

(a) Agency by estoppel or holding out.

(b) Agency by necessity.

(3) By Ratification, *i.e.* when a person ratifies or adopts an act done on his behalf but without his authority. The following rules of ratification must be noted:—

(1) Only the person on whose behalf the contract was made can ratify it.

(2) The act done by the agent on his own behalf cannot be ratified.

(3) The person ratifying should have been in existence at the time the act was done.

(4) The person ratifying must have contractual capacity both at the time the act was done as well as when it is sought to be ratified.

(5) There can be no valid ratification by a person whose knowledge of the facts is defective.

(6) The act ratified must be lawful.

(7) Ratification must be of the whole act.

(8) Ratification must be within a reasonable time.

(4) Different Classes of Agents

(1) Special agent.

(2) General agent.

(3) Universal agent.

(4) Mercantile agents

[a] factor,

[b] broker,

[c] commission agent,

[d] del credere agent,

[e] banker,

[f] auctioneer.

Scope & Extent of Authority of Agent : An agent having an authority to do an act has authority to do every lawful thing necessary in order to do such act.

(1) Actual or Real Authority

(2) Apparent or Ostensible Authority : The principal is bound by an act of his agent which is within the scope of his apparent or ostensible authority even though it may be outside his actual or real authority.

Exceptions : If the third party knows of the limitation of the apparent authority, the principal will not be liable.

(3) Authority in an Emergency : To do all such acts for the purpose or protecting his principal from loss as would be done by a person of ordinary prudence, in his own case, under similar circumstances.

Definition of Sub-Agent: A sub-agent is a person employed by, and acting under the control of, the original agent in the business of the agency (S. 191).

Delegation of Authority: General rule—“*Delegatus non potest delegare*—” i.e. an agent cannot delegate his authority, therefore, an agent cannot normally appoint a sub-agent.

Exceptions

- [1] Where the custom of trade permits the appointment of a sub-agent.
- [2] Where the nature of the agency requires the appointment of a sub-agent.
- [3] Where the principal permits the appointment of a sub-agent.

Sub-agent	Substituted or Co-Agent
1. Appointed by agent	1. Named by agent at request of principal.
2. Is agent of original agent and not of principal because there is no privity contract between principal and sub-agent.	2. Is agent of principal because there is privity of contract.
3. Is responsible to agent.	3. Is responsible to principal.

Termination of Agency**(1) By Act of Parties**

(a) Revocation by principal except,—

- (i) in the case of agency coupled with interest;
- (ii) after the authority has been carried out by agent; and
- (iii) when agency is partially carried out, if the acts already done will be affected by revocation.

(b) Renunciation by Agent

(2) By Operation of Law

- (a) Efflux of time.
- (b) Fulfilment of Performance of object.
- (c) Insolvency of principal.
- (d) Principal becoming alien enemy.
- (e) Death or insanity of principal or agent.
- (f) Destruction of subject-matter.
- (g) Termination of agent's authority.

When Agent is Personally Liable

- (1) Where the contract is with a foreign principal.
- (2) Where the principal is undisclosed.
- (3) Where the principal, though disclosed, cannot be sued.

Duties of Agent

- (1) Obedience.
- (2) Skill and diligence.
- (3) Rendering of proper accounts.
- (4) Emergency.
- (5) Fidelity.

Rights of Agent

- (1) Particular Lien.
- (2) Remuneration.
- (3) Indemnity.
- (4) Compensation.

Duties of Principal

- (1) Indemnity against consequences of all lawful acts (S.222).
- (2) Indemnity against consequences of acts done in good faith though they cause injury to third persons (S. 223).
- (3) Compensation for injury to agent by principal's neglect or want of skill (S. 225).

Rights of Principal

- (1) Compensation for breach of duty.
- (2) Revocation of agent's authority.
- (3) Performance of agent's duties.

TYPICAL QUESTIONS

- 1. (a) Define 'Agent'. What are the duties of an agent?
(b) Under what circumstances may an agency be revoked?
- 2. (a) How may a contract of agency be terminated? When is it irrevocable?

- (b) What do you understand by a 'pretended agent'? What are his liabilities? (Bombay, B.Com., May, 1969)
3. How is agency created? What are the duties of an agent? (Marathwada, B.Com., March/April, 1970)
4. (a) What are the duties of an agent to the principal?
(b) What is the legal position of a sub-agent to (1) the agent and (2) the principal?
5. Distinguish between:
Sub-agent and substituted agent.
6. When may an agent sue or be sued personally on contracts entered by him on behalf of the principal?
7. Write short notes on:
Del credere agent.
8. "An agent shall not delegate his authority". Discuss.
9. What are the rights and liabilities of parties in case of contracts entered into through agents when the principal is undisclosed?
10. Write notes on:
(a) A factor differs from a broker in important respects.
(b) An auctioneer is primarily an agent for the seller but he is an agent for the buyer also.
11. Write short notes on:
(a) Agency coupled with interest.
(b) Agency by estoppel.
12. (a) Can a minor appoint an agent and can he be appointed as an agent?
(b) What is the effect of the termination of an agency with regard to a third party?
(c) Explain the salient features of ratification by a person of an act done without his authority.
13. Discuss the element of consideration with reference to: Contract of agency.
14. Write short notes on
(1) Termination of Agency
(2) Agent's personal liability
(3) Authority of agent in emergency.
15. Write short notes on any three of the following: —
(a) Agency coupled with interest
(b) Sub-agent
(c) Ratification of Agency.

Part 2

SPECIAL ACTS

Chapter 15

PARTNERSHIP

THE INDIAN *Partnership Act*, 1932, which came into force on the 1st day of October 1932 repealed Chapter XI of the Indian Contract Act, 1872, which prior to that date included the Indian Law of Partnership.

Definition and Nature of Partnership

“Partnership” as *defined* by the Act “is the relationship between persons who have agreed to share the profits of a business carried on by all or any of them acting for all” (S. 4). The *English Partnership Act*, 1890, *defines* partnership as “the relation which subsists between persons carrying on a business in common with a view to profit”.

‘*Business*’ is defined as including every trade, occupation and profession. Such business must be a *lawful business* (S. 2) *e.g.* a partnership to commit a criminal offence is invalid. In such a case the firm cannot sue nor can the members of the firm enforce their rights against each other but the firm can be sued by persons who deal with it in ignorance of the taint of illegality.

The persons who have agreed to enter into partnership with one another are called individually “partners” and collectively a “firm”, and the name under which the business is carried on is

called the "firm name" (S. 4). Thus the *relationship* of partners *arises from contract and not from status*, and the business of a Hindu joint family is not the business of partnership (S.5).

Under Hindu law, the family which carries on a trade handed down by ancestors is a *trading family* but the members are not partners. The members of a club, building society, or of a religious or charitable society are not partners.

It will thus be observed that the most important requirement in connection with partnership is the *sharing of profits*. If two or more persons combine under an agreement by which one or more of them is or are to share losses, but no profits that would not constitute a partnership. In other words, *the sharing of profits is prima facie evidence, but not conclusive evidence of partnership*; because, as we shall see, there are specific instances in which though the persons share profits, they do not constitute themselves partners to the firm in which they so share profits, nor do they render themselves liable as partners to the creditors of the firm.¹

A person may become a partner with another person in *particular adventures* of undertakings (S. 8). Such a partnership is dissolved by completion of such adventure of undertaking.

Illegal Partnership

There cannot be a partnership of *more than 10 persons in a banking business*, nor *more than 20 in a trading firm* because such partnerships would be in the unenviable position of not being able to sue and recover their claim in a court of law. Of course, there is nothing to prevent an illegal partnership from being sued² unless the person suing is himself implicated in any illegal act. The members of an illegal partnership cannot call upon each other for contribution or appointment with regard to losses paid by one or more of them on account of the partnership. Neither can they enforce accounts as to partnership dealing from their brother-partners. The only remedy in such cases is to get such an association incorporated under the Companies Act. This principle was enunciated in a Madras case,³ where four unregistered firms carried on a

¹ Though sharing of profits is essential to partnership, sharing of losses is not because a person may become a partner stipulating that he will share only in the profits and not in the losses. (*Raghunandan v. Hormusjee*, 1927, 51 Bom. 342)

² *Brahamayya v. Hamiah* (1920), 43 Mad. 141 54 I.C. 45

³ *Pannaji Devichand v. Senaji Kapurchand*, 50 Mad. 175

certain business in partnership and the total number of all the partners in all the firms exceeded twenty, the partnership of these firms was declared illegal.

It is specifically provided in Section 3 that the *general provisions of the Indian Contract Act, 1872* still apply to partnership firms and their transactions in so far as such provisions are not inconsistent with those of the Indian Partnership Act, 1932. Thus, for example, a partnership formed for an unlawful object is void according to Section 23 of the Indian Contract Act.

Sharing Profits not Conclusive Evidence of Partnership

We have seen that although the sharing of profits is a compulsory element to constitute a partnership, it is only *prima facie* evidence and not conclusive evidence in that regard. Section 6 of the *Indian Partnership Act, 1932*, lays down that—

(1) The sharing of profits or gross returns arising from property by persons holding a joint or common interest in that property does not of itself make such persons partners.

(2) The receipt by a person of (a) a share of the profits of a business, or (b) of a payment contingent upon the earning of profits, or (c) varying with the profits earned by a business does not of itself make him a partner with the person carrying on the business.

(3) Particularly the receipt of such a share or payment as aforesaid in para (2) does not of itself make the receiver a partner with the persons carrying on the business when such share or payment is received by—

(i) a lender of money to persons engaged in or about to engage in any business, or

(ii) a servant or agent as remuneration, or ~~or~~

(iii) the widow or child of a deceased partner as annuity, or

(iv) a previous owner or part owner of the business as consideration for the sale of the goodwill or share thereof.

It may be added here that the profits as contemplated by law in these cases are net profits.

Who is a Partner

Whether a person is a partner or not is an open question and in the absence of an express agreement *all the circumstances* of the

case, besides the incident of sharing profits, would be taken into account by a court of law in deciding whether a particular person was a partner in the firm. Whether a partnership between a given set of individuals exists or not is a question which “must depend on the *real intention and contract* of the parties.”⁴ According to our Act “in determining whether a person is or is not a partner in a firm, regard shall be had to *the real relation between the parties as shown by all relevant facts taken together*” (S. 6).

In short, the following three elements must be present to constitute a partnership:—

(1) There must be an agreement, express or implied among all the persons concerned;

(2) the agreement must be with a view to share profits of a business; and

(3) the business must be carried on by all or any of them acting for all.

In one case an agreement was entered into under which a person was to receive a commission on net profits made by a partnership in consideration of advances made by him to the firm and for his protection he was given certain powers of control. Here on these facts he was not considered to be a partner and liable as such.

Co-ownership

An essential element of partnership is as we have seen, the carrying on of a *business*, therefore the mere fact that a number of persons own some property in common, which produces an income which they divide among themselves does not make them partners. For example, the co-owners of a building are not partners merely because it is let to tenants and the rent is divided among the co-owners. If, however, the building were used as a hotel, run by the owners or their agent they would be considered partners in the hotel-keeping business.

The main points of difference between a partnership and co-ownership as pointed out by the Supreme Court in a recent case are briefly as follows—

- (1) Partnership is the result of an agreement whereas co-owners may arise without any agreement, e.g., through inheritance.

⁴ *Mollwo, March & Co. v. Court of Wards* (1872), L.R. 4 P.C. 419

- (2) Partnership involves the sharing of profits whereas in co-ownership this element is not necessary.
- (3) A partner cannot transfer his interest in the partnership to a third person completely without the consent of the other partners whereas a co-owner can.
- (4) In a partnership each partner acts for all but a co-owner is not necessarily an agent of his other co-owners.

In that case it was held that the mere fact that the co-owners had appointed a common manager of the property did not make them partner.⁵

Partnership Name

A partnership firm may carry on its business under any *name it chooses*; this name may either be the name of one or more of its members or a combined title embracing the names of all, or it may be made up of a designation entirely different from the names of the members composing it. The name under which the business of a partnership is carried on is called the "*firm name*" (S.4). In law, however, a partnership has no distinct existence like that of a joint-stock company, *i.e.*, an existence distinct and independent of the members composing it. All that can be said with regard to the firm's name is that certain persons do business under the name and style of X, Y, Z & Co.

According to *Lind by on Partnership*, (11th ed. at p. 157). "But as the name of a firm is only a convenient mode of designating the firm composing it, any variation among these persons is productive of a new significance of the name. If therefore, a legacy is left to a firm the legacy is payable, unless otherwise expressed, to those who compose the firm at the date of the will and if a legacy is left to the representatives of an old firm it will be payable to the executors of the last survivor of the partners constituting the firm alluded to and not to its successors in business." The firm's name, therefore is only the title under which the partners are supposed to trade and all that can be claimed for it is that by a continuous use of that name in the long course of trading a goodwill may be acquired which may be of value. There is nothing to prevent other persons from using a similar name unless it can be shown that the use of such name would deprive other persons of the advantage of their goodwill by creating an incorrect impression on the minds of

⁵ *Champaban Cane Concern v. State of Bihar* A.I.R. 1963 S.C. 1737.

people that the persons represented by the name are the same as those making up the old firm whose name they are copying.⁶

This is a question of evidence to be decided in each case on its own merits.

Joint Hindu Family Firm

An undivided Hindu family may possess an ancestral business which is a distinct heritable asset and which passes by survivorship to the surviving male members of the joint family. This type of business, known as a *Joint Hindu Family Firm*, is distinguished from an ordinary partnership on many grounds.

The *rights and liabilities* of the members (known as *co-parceners*) of such a firm, are governed mainly by the *Hindu Law* and not by the Indian Partnership Act. Thus a joint Hindu family firm being created *by the operation of law* and not as the result of a contract between the co-parceners, *even a minor can be a member* in such a firm.

The death of a co-parcener *does not put an end* to the family firm as in the case of an ordinary partnership and a *new member* is added every time a *male child* is *born* into the family owning the business.

In an ordinary partnership every partner is presumed to be an agent of the firm for the purposes of the business of the firm but in the case of a joint family firm *only the managing member* (known as *Karta*) has an implied authority to contract debts and pledge the family credit or family property for the purpose of the business of the firm and no other co-parcener has such authority.

Again, in an ordinary partnership every partner is personally liable even to the extent of his separate property for the debts of the firm whereas in a family firm the *liability of a co-parcener is limited* to his share in the joint family property except as regards the *Karta* who is *personally liable*.

Moreover, a member of such a family firm, who voluntarily severs his connection with the firm has *no right to demand an account of the past profits and losses* of the business whereas a retiring partner has such a right.

Who may be Partners

Any person of *full age and sound mind* may be a partner. An alien enemy cannot be a partner during the continuation of hostilities. A minor, as we shall see later in some detail, may not be a partner

⁶ *Massam v. Thorley's Cattle Food Co.* (1880), 14 Ch. Div. 748.

in a firm because in *India* a minor's contract is absolutely void, but with the consent of all the partners for the time being, he may be admitted to the benefits of partnership (S. 30). In *England*, however, as an infant's contracts are merely voidable, an infant may become a partner.

If one of the partners becomes a *lunatic* after his entering into partnership, that will be one of the grounds on which the other partners may apply for dissolution. A new partner in a partnership concern cannot be admitted unless all the original partners have unanimously consented. All who can enter into a legal and binding contract may, in short, be admitted into partnership.

A *married woman* can be a partner and as far as her partnership liabilities are concerned her separate property will be bound by it. All contracts entered into by her as the agent of the partnership will also bind her partners.

Minors

Section 30 deals with the position of minors who have been admitted to the benefits partnership.

A minor who has been admitted to the benefits of partnership with the consent of all the partners has a right to such share of the property and of the profits of the firm as may be agreed upon and he may have access to and inspect any of the accounts of the firm. He has, however, no right to sue the partners for an account or payment of his share of the property or profits except on severing his connection with the firm. Such minor's share is liable for the acts of the firm, but the minor is not personally liable for any such acts. In short the liability of a minor here is a *limited liability i.e.* limited to his share in the property and profits of the firm.

It is further provided that if *within six months* of attaining majority or of obtaining knowledge that he had been admitted to the benefits of the partnership, whichever date is later, the minor gives a *public notice* that he has elected not to become a partner in the firm that notice shall determine his position as regards the firm. If he fails to give such a notice he shall become a partner in the firm on the expiry of the said six months.

Where such a person becomes a partner, the result will be as follows—

(1) his rights and liabilities continue to be those of a minor upto the date he becomes such a partner; but

(2) for all acts of the firm done *since he was admitted* to the benefits of partnership, he shall *become personally liable to third parties*.

His rights as to the share in the property and profits of the firm as such partner naturally remain unaltered, *i.e.* he is entitled to the same share in the property and profits as he was during minority.

If, however, he *elects not to become a partner*,

(1) his rights and liabilities will continue to be those of a minor up to the date on which he gives public notice;

(2) his share will not be liable for any acts of the firm done after the date of the notice; and

(3) he will be entitled to sue the partners for his share of the property and profits (S. 30).

In English Law, an infant's contract being voidable and not void, an infant may be a partner but cannot be sued for debts of the firm during minority. If he wishes to avoid liability, he must repudiate the contract within a *reasonable* time of attaining majority. Even if he elects to remain a partner, he will not be personally liable for partnership debts contracted while he was an infant.

Liability by Holding Out

The doctrine of holding out applies also to partnerships. If a person who is not a partner, "by words spoken or written, or by conduct, represents himself, or knowingly permits himself to be represented, to be a partner in a firm, he is liable as a partner in that firm to anyone who has on the faith of any such representation given credit to the firm" [S. 28 (1)]. This liability by "holding out" is a special application of the doctrine of estoppel. The holding out may be effected in various ways, as in one case, *viz: Waugh v. Carvor*,⁷ Eyre, C.J., says—

"Now a case may be stated in which it is the clear sense of the parties to the contract that they shall not be partners, that *A* is to contribute neither labour nor money and to go still further, not to receive any profits. But if he will lend his name as a partner, he becomes as against all the rest of the world a partner, not upon the ground of the real transaction between them, but upon principles of general policy, to prevent the frauds to which creditors would be liable, if they were to suppose that they lent their money upon the apparent credit of three or four persons, when, in fact,

⁷ 14 A.R.R. 845.

they lent it only to two of them, to whom without the others they would lend nothing."

It, therefore, follows that if a person who is a partner retires from a firm he should give *public notice of his retirement*, otherwise he would be liable for debts of the firm to those who do not know of his retirement and give credit to the firm after his retirement under the belief that he is still a partner [S. 32 (3)]. This public notice of the retirement of a partner or expulsion of a partner has to be given in the local official *Gazette* and in at least one vernacular newspaper circulating in the district where the firm has its place of business. In the case of a registered firm it has to be given to the Registrar of firms also (S. 72). It may be added here that even where a retiring partner takes a written contract from his other partners freeing himself from all liabilities of the firms, such an agreement would not be binding on the creditors of the firms unless those creditors were made parties to such an agreement [S. 32 (2)]. If they do not agree to do so, the position would be that the retiring partner would still be liable (granting that he has given public notice of his retirement) for the debts of the firm incurred during his tenure of partnership to the creditors of the firm and in his turn he would be entitled to be indemnified by his own ex-partners for any money that he may have to pay to such creditors. In the case of *insolvency of his co-partners*, however, *after his retirement* his position would be that he would have to pay out of his pocket the creditors of the firm and put in his claim before the trustees of the insolvent for such money paid out. Of course, a retired partner is not liable to any third party who deals with the firm without knowing that he was a partner.

The Act further lays down that where after a partner's death, the business is continued in the old firm name, the continued use of the name or of the deceased partner's name as a part thereof shall not of itself make his legal representative or his estate liable for any act of the firm done after his death [S. 28 (2)].

Partners' Liability for Partnership Debts

It has been laid down in England and in India that every partner is liable for all debts and obligations *incurred while he is a partner* in the usual course of the business by or on behalf of the partnership; but the person who is admitted as a partner into an existing firm does not thereby become liable to the creditors of such a firm for anything done before he comes in as a partner

(S. 31). Thus it should be noticed that the liability of partners is limited with regard to debts of the firm incurred in the regular course of the business of partnership. Every partner is liable *in India jointly and severally* for all acts of the firm done while he is a partner (S. 25).

In the English Act the liability is only joint. In the case of a joint liability the rule is that if a debt is due from a partnership firm made up of, say, *A, B and C*, all the partners *A, B and C* must be sued in order to make them all liable for their debts. If, however, the creditor chooses to pick out only *A* he is, no doubt, at liberty to do so, but supposing that he fails in satisfying his debts out of the estate of *A*, he cannot proceed against *B and C* for the balance of the debts which remain unpaid.

In *India*, however, the liability being joint and several the creditor can sue at his option either all jointly or each of them separately.

It should however, be noted that a *partner is liable only for those debts which were incurred during the time he was a partner.* Thus if a new partner is admitted into an old firm, he is not liable for any debts incurred by the said firm prior to the date of his joining the partnership, *unless* one of terms on which he is admitted into partnership is that he is liable for debts incurred prior to his joining the firm. This is of course, a special agreement between him and his brother partners and as such the agreement cannot be taken advantage of by outsiders, *i.e.*, creditors of the firm. Thus if *X* was a creditor of the firm for Rs 10,000 prior to the new partner joining the firm of *A, B and C* and there is an express agreement that the new partner is to be liable for the debts of the firm in proportion to his share of profits, the said agreement can be enforced against the new partner by *A, B or C*, but the creditor cannot sue the new partner separately for payment of Rs 10,000 or even a portion equivalent to the new partner's share in the profits.

In one case one of the partners obtained certain information from a clerk of a competing firm by bribing him, and used that information for the benefit of his firm and to the harm of the competing firm. It was held that his partners were liable to pay compensation to the competing firm.⁸ It must be noticed here that the *neglect or fraud ought to have been committed in the regular course of the business of the firm* in order to make the other partners liable:

⁸ *Hamlyn v. Houston & Co.* (1903), 1 K.B. 81.

e.g., it has been decided that in the case of solicitors when money is given to them to be invested by them in a specified manner, it is said to be so entrusted to them in the regular course of the business and if, therefore, one of the members of the firm receives the money and misappropriates it, the firm would be liable.⁹ If, however, the money was given to a partner with certain instructions to invest at the discretion of the partner, the payment is not held to have been made in the regular course of the business of the firm and, therefore, misappropriation by a member of the firm is not binding on the firm.¹⁰

Of course as between partners themselves Section 10 expressly provides that "*Every partner shall indemnify the firm for any loss caused to it by his fraud in the conduct of the business of the firm*". This section is imperative and does not give a partner power to contract himself out of his liability for fraud whereas Section 13 allows a partner to enter into a contract with the other partners, whereby they will not be liable to the firm for losses arising through their wilful neglect in the conduct of the partnership business.

Powers and Duties of Partners

Every partner has, generally speaking, the power to do *all acts necessary for or usually done* in, carrying on the business of the partnership, of which he is a partner, unless there is an agreement to the contrary. A partner, subject to the provisions of the Indian Partnership Act, 1932, is *the agent of the firm* for the purposes of the business of the firm (S. 18). Thus the act of a partner which is done to carry on in the usual way, business of the kind carried on by the firm binds the firm, provided it is done and executed in the firm's name or in any other manner expressing or implying an intention to bind the firm [Ss. 19(1) & (22)]. This authority of a partner to bind his firm is called his "implied authority".

It will thus be seen that it is quite open to the members of a firm to enter into an *agreement* under which they can *restrict the power of any of the partners* by arranging that certain members should only attend to a particular branch of the business and enter into contracts with regard to that branch only, and that certain others should look after other branches of management or take no active part except in financing the business. Such an agreement would, no doubt, be binding upon the partners and also on those

⁹ *Blair v. Bromley* (1847), 2 Ph. 354.

¹⁰ *Harman v. Johnson* (1853), 22 L.J.Q.B. 297.

who are aware of, or who had notice of, those terms in the partnership agreement. In short, the agreement to this effect would be binding upon the partners among themselves. The result would be that if one of the partners, in spite of an agreement to the contrary, were to enter into a contract in the regular course of the business of the firm which by agreement he was not entitled to do, *an innocent outsider would not be bound by such clause in the partnership agreement* of which he had no notice and can still look to the firm for his payment. It is, however, open to the firm to pay the money and obtain compensation from the partner who has violated the clause in the partnership agreement. Besides, the *general powers* of partners are *limited only to the doing of those acts which are usual and necessary in the ordinary course of the business of the firm* and therefore they do not confer any extraordinary powers because it has been laid down that “a power to do what is usual does not include a power to do what is unusual, however urgent” (*Lindley on Partnership*).

The *general duties* of partners are to carry on the business of the firm to the greatest common advantage, to be just and faithful to each other, and to render true accounts and full information of all things affecting the firm to any partner or his legal representative (S. 9).

What a Partner Cannot Do under Implied Powers

A partner is an agent of the firm for the purposes of business of the firm and under Section 19 of the Act an act of the partner which is done to carry on the business of the kind carried on by the firm binds the firm. This authority to bind the firm is known as ‘*implied authority*’ of a partner. Partners in a firm may by a contract between them extend or restrict the implied authority of any partner but notwithstanding such restrictions any act done by a partner on behalf of the firm which falls within his implied authority binds the firm unless the person dealing with the partner knows of the restrictions or does not know or believe that partner to be a partner. In the absence of usage or express authority from all other partners the implied authority of a partner does *not* empower him to—

(1) submit a dispute relating to the business of the firm to arbitration,

(2) open a banking account on behalf of the firm in his own name,

- (3) compromise or relinquish any claim or portion of a claim by the firm,
- (4) withdraw a suit or proceedings filed on behalf of the firm,
- (5) admit any liability in a suit or proceeding against the firm,
- (6) acquire immoveable property on behalf of the firm,
- (7) transfer immoveable property belonging to the firm, or
- (8) enter into partnership on behalf of the firm [S. 19 (2)].

A partner has, however, implied authority to do the following acts—

- (1) to enter into all contracts usual in the ordinary course of business,
- (2) to engage servants and agents or hire the services of any persons,
- (3) to draw cheques in the name of the firm,
- (4) to recover a debt due to the firm, and
- (5) payment by a debtor to any partner extinguishes the claim of all the partner and discharges the debtor.

The same principle applies when a decree is obtained by the firm and the judgment debtor makes payment to any one partner.

- (6) to make payment of a debt or part payment of the debt to any creditor of the firm,
- (7) to accept a bill of exchange in respect of a debt due to the firm,
- (8) to bring and defend suits in the name of the firm.

Whether a partner has implied *authority to borrow money* depends on the question whether it is usual to do so in the particular business. A partner of a trading firm has certainly the power to borrow moneys. In such a case no duty is cast on the partner advancing the money to make any further inquiries. A firm has been defined to be a trading firm if its business consists in buying and selling goods. However, when the business is not of a commercial nature as for instance the business of a solicitor or a doctor, a partner does not have an implied authority to borrow moneys.

Special Agreement, Emergency and other Incident

Of course by a *special agreement* it is open to partners to extend or even restrict the implied authority of any partner, but this is subject to the rule that any *such restriction shall not bind an innocent*

outsider who deals with a partner within his implied authority without knowing of such restriction or without knowing or believing that partner to be a partner (S. 20). In an *emergency*, however, a partner has authority to do all such acts for the purpose of protecting the firm from loss as would be done by a person of ordinary prudence, in his own case, acting under similar circumstances and such acts will bind the firm (S. 21).

In any case, that act or instrument done or executed by a partner or other person on behalf of the firm must be done or executed in the firm's name or in any other manner expressing or implying an intention to bind the firm (S. 22). On the same principle, an *admission or representation* by a partner concerning the affairs of the firm is evidence against the firm if made in the ordinary course of business (S. 23). *Notice* to a partner habitually acting for the firm of a matter relating to the affairs of the firm operates as notice to the firm, except in the case of a fraud on the firm committed by or with the consent of that partner (S. 24).

Conduct of Business and Mutual Rights and Liabilities

The mutual rights and liabilities of a partner may be determined by agreement, express or implied between the partners and such an agreement, may be varied by the express or implied consent of all the partners (S. 11).

Thus, *subject to contract* between partners—

(1) every partner has a right to take part in the conduct of the business;

(2) every partner is bound to attend diligently to his duties in the conduct of his business;

(3) any difference arising as to ordinary matters connected with the business may be decided by a majority of the partners, and every partner shall have the right to express his opinion before the matter is decided, but no change may be made in the nature of the business without the consent of all the partners;

(4) every partner has a right to have access to and to inspect and copy any of the books of the firm;

(5) a partner is not entitled to receive remuneration for taking part in the conduct of the business;

(6) the partners are entitled to share equally in the profits earned, and must contribute equally to the losses sustained by the firm;

(7) where a partner is entitled to interest on the capital subscribed by him such interest is payable only out of profits;

(8) a partner making for the purposes of the business, any payment or advance beyond the amount of capital he has agreed to subscribe, is entitled to interest thereon at the rate of six per cent per annum (5 per cent in *English Law*).

(9) the firm must indemnify a partner in respect of payments made and liabilities incurred by him—

- (i) in the ordinary and proper conduct of the business; and
- (ii) in doing such act, in an emergency, for the purpose of protecting the firm from loss, as would be done by a person of ordinary prudence, in his own case, under similar circumstances;

(10) a partner shall indemnify the firm for any loss caused to it by his wilful neglect in the conduct of the business of the firm (Ss. 12 & 13).

Continuation after Expiration of Term

Where a partnership is formed for a fixed period and on the expiration of that period the partners continue business, the presumption is that the mutual rights and duties of the partners (unless there is an agreement to the contrary) remain the same as they were before the expiration of the term and the partnership thereafter is naturally to be taken as a *partnership at will* and the mutual rights and duties as stated above are to continue so far as they are consistent with the incidents of partnership at will [S. 17(b)].

Partnership at Will

A partnership is regarded as a *partnership at will* when “no provision is made by contract between the partners for the duration of their partnership, or for the determination” of their partnership (S. 7).

The most important incident of a partnership at will is that “the firm may be *dissolved* at any time by any partner giving notice in writing to all the other partners of his intention to dissolve the firm” [S. 43(1)]. When such notice is given, “the firm is dissolved as from the date mentioned in the notice as the date of dissolution, or, if no date is mentioned, as from the date of communication of the notice” [S. 42(2)].

Interest on Capital

Partnerships are formed between individuals bringing in capital at varying figures, and while adjusting accounts at periodic intervals, interest at a fixed rate per cent is frequently allowed on the capital to each of the partners concerned. It may, however, be noted that in law *no partner is entitled to claim interest on his capital in the absence of an agreement express or implied*. If the partnership has been carrying on business for some length of time, during which time accounts have been periodically balanced after allowing interest on the capital of the partners, that circumstances will help to prove that there was an implied agreement between the partners to allow interest on the capital brought in by each member of the partnership. If, however, no agreement as to interest exists, and if there is no indication of it in the accounts of the type referred to above, the partner who brought in his agreed share of capital cannot claim interest on it, in case any of the other partners fail to bring in his agreed share of capital in full even in winding up. The *advances* made by one or more of the partners to the firm, *over and above the agreed share capital*, do not fall under this rule as such advances *are to be treated as loans* from the partners concerned (unless otherwise agreed) on which the partners advancing will be entitled to simple interest at the rate of *6 per cent in India and 5 per cent in England*.

Property and Profits of the Firm

All property, and rights and interests in property originally brought into the firm or acquired by or for the firm by purchase or otherwise become partnership property *subject to contract* between the partners. This property naturally includes the goodwill of the business (S. 14). All partnership property must be held and used by the partners exclusively for the purposes of the business, subject of course to any contract between them (S. 15). Unless there is an implied or express contract between the partners to the contrary, all profits derived by a partner for himself or from the use of partnership property, business connection or name or through any competing business carried out by him must be accounted for and paid by him to the firm (S. 16).

Dissolution of Firm

The dissolution of a partnership firm may arise in any of the following ways.

- (1) By agreement (S. 40).
- (2) By notice in writing in the case of a partnership at will (S. 43).
- (3) Compulsorily in two cases (S. 41).
- (4) On the happening of certain contingencies mentioned in Section 42 unless there is a contract to the contrary.
- (5) By a suit under Section 44.

A partnership firm may be *dissolved* with the consent of all the partners or in accordance with a contract (S. 40).

Where it is *partnership at will*, it may be dissolved as from the date mentioned in the *notice given in writing* by any partner to all other partners. If no such date is mentioned it is dissolved from the date of the communication of the notice (S. 43).

A firm is dissolved *compulsorily* (1) when all partners, or all but one partner, are *adjudicated* as insolvent, or (2) where an event has happened which makes it *unlawful* for the business of the firm to be carried on or for the partners to carry it on in partnership (S. 41).

A firm is also dissolved (*subject, of course, to contract between the partners*) (1) by the expiry of the term if it is for a fixed term; (2) by the completion of one or more enterprises to carry on which the partnership was constituted; (3) by the death of a partner; and (4) by the adjudication of a partner as an insolvent (S. 42). In this case the adjudicated partner ceases to be a partner on the date on which the order of adjudication is made irrespective of the fact whether the firm is dissolved or not (S. 34). Where by a special contract between the partners the firm is not dissolved on the insolvency or death of a partner, the estate of the insolvent or deceased partner is not liable for any act of the firm done after the order of adjudication or death, as the case may be, and in the case of insolvency, the firm is not liable for any act of the insolvent after the adjudication [Ss. 34 (2) and 35].

Outgoing Partner's Right to Compete

An outgoing partner is free to carry on a business of a competing nature and to advertise it, unless he has given an agreement to his other partners that on ceasing to be a partner he will not carry on such business for a specified period or within specified local limits. Such an agreement will be binding on the outgoing partner, if the restrictions imposed as above are reasonable.

When an outgoing partner has not given any such undertaking and wishes to carry on a competing business, the law imposes *three restrictions* on him, *i.e.*, he may not—

- (1) use the firm name,
- (2) represent himself as carrying on the business of the firm, or
- (3) solicit the custom of persons who were dealing with the firm before he ceased to be a partner.

It should be noted that these restrictions are also *subject to an agreement to the contrary* with the old partners (S. 26).

Outgoing Partner and Subsequent Profits

Where a partner retires or dies and the continuing or surviving partners carry on the business of the firm without any settlement of accounts as between them and the outgoing or deceased partner, then unless there is some special contract to the contrary, the outgoing partner or the estate of the deceased partner will be entitled to such share of the profits made since he ceased to be a partner as may be attributable to the use of his share or to interest at the rate of six per cent per annum on the amount of his share in the property of the firm (S. 37).

Expulsion of a Partner

A partner may be expelled from the firm only *if powers of expulsion are given by contract* to any majority of the partners and such powers are exercised in *good faith* (S. 33). The decision of the majority will not be considered to be in good faith unless it is made with an honest view to the interests of the firm and after notice to the partner with an opportunity to be heard. If the expulsion is not according to the provisions of Section 33 it will be entirely ineffective and the partner concerned will not cease to be a partner.

Dissolution by a Suit

A partner may, by bringing a suit, get a partnership dissolved on any of the following grounds—

- (1) that a partner has become of unsound mind, in which case the suit may be brought as well by the next friend of the partner who has become of unsound mind as by any other partner;
- (2) that a partner, *other than the partner suing*, has become in any way permanently incapable of performing his duties as partner;

(3) that a partner, *other than the partner suing*, is guilty of conduct which is likely to affect prejudicially the carrying on of the business, regard being had to the nature of the business;

(4) that a partner, *other than the partner suing*, wilfully or persistently commits breach of agreements relating to the management of the affairs of the firm or the conduct of its business, or otherwise so conducts himself in matters relating to the business that it is not reasonably practicable for the other partners to carry on the business in partnership with him;

(5) that a partner, *other than the partner suing*, has in any way transferred the whole of his interest in the firm, to a third party, or has allowed his share to be charged under the provisions of Rule 49 of Order XXI of the First Schedule to the Code of Civil Procedure, 1908, or has allowed it to be sold in the recovery of arrears of land revenue or of any dues recoverable as arrears of land revenue due by the partner;

(6) that the business of the firm cannot be carried on save at a loss; or

(7) on any other ground which renders it just and equitable that the firm should be dissolved (S. 44).

(1) Insanity

In this case a suit may be brought either by the next friend of the partner who is so incapacitated or by any of the other partners of the firm. Of course, *until* such a suit is filed and a decree of dissolution obtained the partnership is *not dissolved*. It has been laid down in *England* that "when a partner is affected with insanity the continuing partner may, if he thinks fit, make it a ground of dissolution but in that case I consider, that in order to make it a ground for dissolution he must obtain a decree of the court. If he does not apply to the court for a decree of dissolution it is to be considered that he is willing to wait to see whether the incapacity of his partner may not prove merely temporary. If he carries on the partnership business in the expectation that his partner may recover from his insanity, so long as he continues the business with that expectation or hope, there can be no dissolution."¹¹

It should be noted that lunacy is a ground of dissolution because it renders the lunatic permanently incapable of carrying out his part of the partnership agreement *i.e.*, providing he is an

¹¹ *Jones v. Noyz*, M.N.K. 125.

active or working partner. Thus in the case of a dormant or sleeping partner, lunacy is not a ground for dissolution in the absence of special circumstances.

(2) Incapacity

Incapacity here should be *permanent*. The principle was laid down years ago in England where in one case a partner was incapacitated through a paralytic attack from performing his duties as a partner but it was proved that his health was improving and that his incapacity was temporary. The court thereupon refused to pass a decree of dissolution.¹²

(3) & (4) Misconduct and Wilful Breach

Where a partner is guilty of conduct which is likely to affect prejudicially the carrying on of the firm's business, say when he commits a fraudulent breach of trust, it is open to his other partner or partners to apply for a dissolution with a view to get rid of him. Similarly, where there is a persistent breach of agreement relating to the management of the affairs of the firm or the conduct of its business which makes it impracticable for other partners to carry on business in partnership with him, any of his partners can move the court for a decree of dissolution with a view to get the offending partner removed. In these cases the *principle* involved is that mutual trust and confidence which is the essence or partnership can no longer subsist under the circumstances.

(5) Transfer of Interest

If a partner transfers, assigns or mortgages the *whole* of his share to *an outsider*, that is a *ground* for any of his partners to apply to the court for *dissolution* of the partnership. The transferee or sub-partner in such a case acquires no right to an account from the firm or any of its members except the one whose sub-partner he happens to become by such a transfer. On the same principle, if a partner mortgages his share, the mortgagee will not acquire a right to an account with regard to profits from the other partners. He has to look to his mortgagor to settle this item for him in the case of a dissolution. However, the mortgagee or creditor or co-partner would acquire a right to account as from dissolution. Section 44 (e) further provides that if a partner has allowed his share to be charged under the provisions of Rule 49. Order XXI of the Code of Civil Procedure, 1908, the result will be the same, *i.e.*,

¹² *Whitewell v. Arthur* 35 Bear, 140.

it will give a right to any of the other partners to apply to the court for a dissolution order. Under this order it is provided that the Court may on the application of the holder of a decree against the partner make an order charging the interest of such partner in the partnership property and profits with payment of the amount due under the decree, and may, by the same or a subsequent order, appoint a receiver of the share of such partner in the profits (whether already declared or accruing) and of any other money which may be coming to him in respect of the partnership, and direct accounts and inquiries and make an order for the sale of such interest or other orders as might have been directed or made if a charge had been made in favour of the decree-holder by such partner, or as the circumstances of the case may require. *The other partner or partner or partners shall be at liberty at any time to redeem the interest charged, or in the case of a sale being directed, to purchase it.*

(6) Only at a Loss

The court will allow dissolution of the ground of loss where it can be shown that though the term fixed by the contract for the duration of the partnership is unexpired, the business can be carried on only at a loss and there is no chance of making profits in the future.

(7) Just and Equitable

The Indian Partnership Act, 1932, has left the door open by which the court can order dissolution "on any other ground" which renders dissolution just and equitable. It may be noted here that in the Companies Act of England and India a "just and equitable" clause exists similar to this under which the court can decree a compulsory winding up of a company. According to older decisions the ground on which the dissolution is asked should be *ejusdem generis* to those laid down above in the preceding clauses. The later decisions held that this provision does not restrict the court to the grounds similar to those enumerated in the section but the courts are free to decree a dissolution in any case whatsoever where in their opinion it is just and equitable that such an order should be passed.

Public Notice of Dissolution

The Act makes it clear that on the dissolution of a firm a *public notice* should be given, failing which the partners continue to be liable for the act of any one of them which would have been the act

of the firm if done before dissolution. This, of course, does not apply to the estate of a partner who dies or is adjudicated an insolvent or to a partner who was not known to the person dealing with the firm to be a partner, for acts done after such person ceases to be a partner. The notice may be given by any partner (S. 45).

Rights after Dissolution

All partners or their representatives have a right to have the *property of the firm applied in payment of debts* and liabilities of the firm and to have the *surplus distributed* among the partners or their representatives according to their right (S. 46). The authority of each partner to bind the firm and the other *mutual rights and obligations continue notwithstanding dissolution so far as may be necessary to wind up the affairs* of the firm, also with regard to the completion of a transaction begun, but unfinished at the time of the dissolution. This rule of course does not bind the firm in respect of the acts of a partner who has been adjudicated an insolvent (S. 47).

After a firm is dissolved, subject to contract to the contrary, every partner or his representative may retain any other partner or his representative from carrying on a similar business in the firm name or from using any of the property of the firm for his own benefit, until the affairs of the firm have been completely wound up. Of course this does not affect the right of a partner or his representative to use the firm name if he has brought the firm's goodwill (S. 53).

Agreements in Restraint of Trade

According to Section 27 of the Indian Contract Act, "every agreement by which any one is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void". That section makes an exception of the restraint that may be placed on the seller of goodwill. The Indian partnership Act, in several sections, provides *other exceptions to the rule against agreements in restraint of trade*.

According to Section 11, a partnership agreement may provide that a partner shall not carry on any business other than that of the firm while he is a partner.

Section 36 (2) provides that a partner may make an agreement with his partners that on ceasing to be a partner he will not carry on any business similar to that of the firm within specified local limits and that such an agreement will be valid if the restrictions are

reasonable. Section 36 thus regards an outgoing partner as having sold his share of the goodwill to the remaining partners.

Section 54 provides that partners may, either upon dissolution or in anticipation of dissolution of the firm, make an agreement that some or all of them will not carry on a business similar to that of the firm within a specified period or within specified local limits and provided such restrictions are reasonable, such an agreement will be valid.

According to Section 55 (3) a partner may, upon the sale of the goodwill of a firm, make an agreement with the buyer that such partner will not carry on any business similar to that of the firm within a specified period or within specified local limits, and such an agreement will be valid provided the restrictions are reasonable.

Premium and Premature Dissolution

Where a partner has paid a premium on entering into a partnership for a fixed term without any special provision with regard to the return of it on dissolution, the Indian Partnership Act, 1932, lays down in Section 51 that in such cases where the firm is dissolved before the expiry of the term, otherwise than by the death of a partner the premium or such part thereof as may be reasonable should be repaid, regard of course being had to the terms on which he became a partner and the length of time for which he continued as such. This rule of course will *not* apply, where (1) the dissolution was mainly due to his own misconduct, or (2) was brought about in pursuance of an agreement containing no provision for the returning of the premium or any part thereof.

Partnership through Misrepresentation

If a person is induced to become a partner through the misrepresentation or fraud of any of the partners, the misrepresented partner on rescission of the contract will have a *lien* or right of retention *on the surplus of the assets* of the firm after payment of its debts, for any sum that he may have paid for the purchase of his share or as contribution towards his capital. He also *ranks as a creditor* of the firm in respect of any payment made by him towards the debts of the firm. Besides these he has a *right to be indemnified by the partner or partners guilty of fraud or misrepresentation* against all the debts of the firm (S. 52).

Payment of Firm's and Separate Debts

It frequently happens that when a firm is being dissolved, particularly in an insolvent condition, there is not enough money to go

round to the creditors of the firm on the one hand and to the separate outside creditors of each partner on the other hand. In such a case according to Section 49, the joint debts of the firm have to be first met from the property of the firm and the outside and private debts of each partner have to be paid in the first instance, from the separate property of each partner concerned. If there is any surplus either way, it is transferred into the payment of either the firm's debt or the individual partner's debt as the case may be.

Accounts and their Inspection

The usual practice among businessmen is to keep separate accounts of each partner in the partnership ledger, and to credit each partner with his share of capital actually brought in, plus all advances on account of capital. This account is debited with all withdrawals on account of capital. The profits made are also credited to this account in the proportion agreed upon and losses debited. The withdrawals for personal expenses or against profits are also debited.

Every partner has a *right to see that proper accounts* of the partnership transactions are *maintained* which should be *open for the inspection of every partner*. It is within the right of every partner to get these accounts inspected by any agent he appoints (particularly an expert); provided, of course, that the agent is a person against whom no reasonable objection can be raised by other partners.¹²

It may be added that in cases where the court directs the accounts to be taken all partners who are in possession of these books and vouchers must produce them, failing which the party who withholds, or who is guilty of having destroyed them, will find all presumptions against him.

Continuing Guarantee

A continuing guarantee given either to a firm or to a third person in respect of the transactions of a firm is, in the absence of an agreement to the contrary, *revoked as to future transactions by any change in the constitution of the firm* to which, or in respect of which, such a guarantee was given (S. 38).

Joint and Separate Debts

Where there are joint debts due from the partnership and also separate debts due from any partner the *partnership property* must be

¹² *Bevon v. Webb* (1909) 2, Ch. 59

applied in the *first* instance in payment of the debts of the firm, and, if there is any surplus, then the share of each partner must be applied in payment of his separate debts or paid to him. The separate property of any partner must be applied first in the payment of his separate debts, and the surplus (if any) in the payment of the firm.

The principle, as laid down in the section, has been long established in England. Lord King, in *ex parte Cook*¹⁴ used the following words, "It is settled, and is a resolution of convenience, that the joint creditors shall be first paid out of the partnership or joint estate, and the separate creditors out of the separate estate, of each partner; and if there be a surplus of the joint estate, besides what will pay the joint creditors, the same shall be applied to pay the separate creditors, and if there be, on the other hand, a surplus of the separate estate beyond what will satisfy the separate creditors it shall go to supply and deficiency that may remain as to the joint creditors".

Partners' Rights and Obligations after Dissolution

After the dissolution of partnership, the rights and obligations of the partners *continue in all things necessary for the winding up of the business of the partnership.*

Accounts on Dissolution

The principle on which the partnership accounts ought to be finally settled on a dissolution, are now laid down in Section 48 of the Indian Partnership Act, 1932, as follows—

In settling the accounts of a firm after dissolution, the following rules shall, *subject to agreement by the partners*, be observed:—

(a) Losses, including deficiencies of capital, shall be paid first out of *profits*, next out of *capital*, and, lastly, if necessary by *the partners individually* in the proportions in which they were entitled to share profits.

(b) The assets of the firm including any sums, contributed by the partners to make up deficiencies of capital, shall be applied in the following manner and order:—

(i) in paying the debts of the firm to third parties;

(ii) in paying to each partner rateably what is due to him from the firm for advances as distinguished from capital;

¹⁴ 2 P.W. 500

(iii) in paying to each partner rateably what is due to him on account of capital; and

(iv) the residue, of any, shall be divided among the partners in the proportions in which they were entitled to share profits.

It may be added here that *a suit for accounts in dissolution of partnership is to be brought within three years of the date of dissolution.*

It may be further noticed that each and every partner has *a right on dissolution, to insist on a sale of the partnership assets.* No partner, in the absence of an agreement to that effect, can claim to have his own share or that of his partner's value by a valuer or to have it divided in specie. Besides, the right of winding up the affairs of a partnership in dissolution is a personal right belonging to each of the members of the firm which cannot be taken out of the hands of the other partners by the personal representatives or trustees of a deceased or bankrupt partner. The general rule with regard to the above is stated thus: "On the dissolution of the partnership all the property belonging to the partnership shall be sold, and the proceeds of the sale after discharging all the partnership debts and liabilities shall be divided among the partners debts and liabilities shall be divided among the partners according to their respective shares in capital".¹⁵ In settling the accounts of a firm after dissolution, the *goodwill* must, subject to contract between the partners, be included in the assets and may be sold either separately or along with other property of the firm [S. 55 (1)].

Limitation

The period of limitation for a suit for accounts and the share of profits of a dissolved partnership is three years from the date of dissolution.

When the suit is in the nature of a suit *for dissolution of the partnership* and accounts and *not* for accounts of a dissolved partnership, the period of limitation is three years from the time when the cause of action accrues. The period of limitation has been cut down from six years to three years by the new Act, namely, The Limitation Act, 1963.

Goodwill

Goodwill plays so important a part in partnership affairs that it will not be out of place to deal with it here.

¹⁵ *Darby v. Darby* (1856), Crew p. 505

Goodwill is defined as *any advantage* that a firm or a company enjoys through the *established reputation* and the *business connection* which it has built up through previous dealings, advertisement, etc. If a new partner joins a firm with an established reputation, he no doubt, obtains the ready benefit of the firm's reputation which was established through the exertions of the old partners; or, where the firm's business is sold, the new owners of the business would benefit through its established reputation, thereby gaining a ready connection which would otherwise have to be established through incessant work for a number of years.

Mr. Justice Warrington,¹⁶ defines goodwill as follows. "The goodwill of a business is the advantage, whatever it may be, which a person gets by continuing to carry on, and by being entitled to represent to the outside world, that he is carrying on a business which has been carried on for sometime previously." It is also defined by Lord Eldon in *Cruttwell v. Lye*¹⁷ as "the possibility that the old customers will resort to the old place".

Of course these are not comprehensive definitions, but they will give the student an idea as to what the term "goodwill" embraces.

In the case of partnership it has been taken as settled law that in the absence of an express agreement, *goodwill is the Common property of the firm's partners*. It will be seen that where a partner retires from the firm or when he dies, he or his heirs will be entitled to see that the figure of goodwill is included in the calculation of capital.

In this case of an *outgoing or deceased partner*, the calculation of capital to be paid to him should be made up to the date of his retirement or death, including profits, made up to that date, and his share of the goodwill in the firm. This has to be done because, according to partnership law, the partnership is dissolved from the date of the death of a partner, his bankruptcy or of course, the date of his retirement. On these occasions the calculation of goodwill gives rise to difficulties, in case the partnership agreement does not include clauses clearly stating the lines on which the goodwill is to be calculated. Under these circumstances, the only method of arriving at goodwill is by valuation, and the proportion to be credited to the deceased partner's capital account is the proportion

¹⁶ *Hill v. Ferris* (1905), 1 Ch. p. 471

¹⁷ (1810), 17 Ves. 356

of the valuation, *according to his share of the profits* of the partnership. The partnership agreement generally provides for calculation on the basis of so many years' average profits or, as is often the case, it is agreed that for a certain number of years a fixed annuity or a fixed share of net profits, should be paid to the outgoing partner or his representative. The person who purchases the goodwill in a firm should see that an express agreement is taken from the partners not to carry on another similar business within a specified period or within specified local limits and provided that the restrictions are reasonable such an agreement will be valid [S.55(3)]. If no such agreement is made when the goodwill of a firm is sold, any partner may carry on a business competing with that of the buyer and he may even advertise it but subject to agreement between him and the buyer he cannot —

- (a) use the firm name;
- (b) represent himself as carrying on the business of the firm; or
- (c) solicit the custom of persons who were dealing with the firm before its dissolution [S.55(2)].

REGISTRATION OF FIRMS

The Partnership Act of 1932 has introduced a new departure, *viz.*, registration of partnership firms. Though *registration is optional* and not compulsory in the sense that no penalty is imposed, the sections are so framed as to provide a medium for sufficient indirect pressure to be brought to bear on partners to have the firm and themselves registered, as we shall see presently. It may be added, however, that the sections as to registration came into force as and from October 1, 1933.

The idea was that the registration should be introduced gradually in such provinces as are sufficiently developed for the purpose and to leave off undeveloped areas for the present; thus the State Government of any State, is given the power by notification in the Official Gazette to direct to what State or any part of it the provisions applying to registration shall not apply (S.56).

How to Register

The Registration is to be effected by officers known as *Registrar of Firms* of the respective areas by either sending through the post or delivering in person *a statement on a prescribed form* accompanied by a prescribed fee. The statement is to contain (1) the name of

the firm, (2) the place or principal place of business of the firm, (3) the names of any other places where the firm carries on business, (4) the date on which each partner joined the firm, (5) the names in full and permanent addresses of the partners and (6) the duration of the firm. This statement must be *signed by all partners* or their duly authorized agents [S. 58(1)].

All alterations in the name or location of the principal place of business of such a firm have also *to be notified* to the Registrar in similar fashion (S. 60). Similarly, *a change in the constitution* has to be notified either by an incoming, continuing or outgoing partner. A dissolution may also be notified by a partner or an agent of a partner who was a partner immediately before the dissolution (S. 63). The closing and opening of branches and changes in names or addresses of partners may also be notified by any partner or agent of the firm (Ss. 61 & 62).

The *register is open for inspection to any person on payment* of the prescribed fee, together with all statements notified and intimations filed (S. 66).

Restriction as to Name

Registered firms cannot use the following words in connection with their names, "Crown", "Emperor", "Empress", "Empire", "Imperial", "King", "Queen", "Royal", or words expressing or implying the sanction, approval or patronage except when the State Government gives its written consent [S. 58(3)].

Registration and Minor Partner

When a minor is admitted to the benefits of partnership and the said minor attains majority he or his duly authorized agent may notify whether he elects to become a partner or not [S. 63(2)]. The Registrar in all these cases makes a record of such notice on his register. The Registrar may be notified as to any mistake by the Registrar himself or the court deciding any matter relating to a registered firm may direct the Registrar to make any amendment of the entry in the register of firms relating to such firms which is consequential upon its decision (Ss. 64 & 65).

Effect of Non-Registration

The effect of non-registration is that a partner cannot file a suit to enforce a right *arising from* a contract or conferred by this

Act against the firm or against any person who is alleged to be a partner in the firm unless the said firm is registered and the person who is suing has been shown in the Register of Firms as a partner in the firm. On the same footing a firm cannot sue in any court a third party on any right arising from a contract unless the said firm is registered and the persons suing are or have been shown in the register of firms as partners of the firm. These rules will also apply to a claim for set-off or other proceedings to enforce a right arising out of a contract, but will not affect the following *viz*—

(a) The enforcement of any right to sue for the dissolution of a firm or for accounts of a dissolved firm, or any right or power to realize the property of a dissolved firm, or

(b) the powers of an official assignee, receiver or Court under the Presidency Towns Insolvency Act, 1909, or the Provincial Insolvency Act, 1920 to realize the property of an insolvent partner.

The *only exceptions* in this case being firms or partners in firms having no place of business in India or having places of business situated in areas to which the Government notification does not apply and to a suit or claim of set-off not exceeding Rs 100 in value.

The Select Committee Report states that the position created is that *the third party's right to sue the firm is kept intact, but in case of suits by the firm or partners inter se or against third parties, registration is compulsory*, as such suits cannot be filed by unregistered firms, or their partners. In the case of suits against third parties, it is open to the firm to get registered as soon as litigation is in sight. The effect of this regulation, it is submitted, is that partners of every responsible firm would prefer to get registered because otherwise they may not be able to file suits against the firm or against one or more of their partners.

False Statement

A penalty which may extend to imprisonment upto three months with or without fine is laid down for any person who sign any statement, or amending statement, or notice, or intimation in connection with registration of firms, in which a false statement appears which *to his knowledge* happens to be false or *which he does not believe to be true* (S. 70).

LIMITED PARTNERSHIPS IN ENGLISH LAW

In England there is an Act called the *Limited Partnerships Act, 1907*, under which limited partnership firms may be formed. We

have no such Act in India and therefore limited partnerships cannot be formed under Indian Law.

As in the case of other partnerships, in a limited partnership also there must be not more than twenty partners and in the case of banking business, not more than ten.

An important condition of a limited partnership is that there must be at least *one general partner and at least one limited partner*.

A *limited partner* is really a financing and dormant partner. He contributes a stated amount of capital and his liability for the firm's debts is limited to that amount. If he withdraws his capital he will be liable for the firm's debts up to the amount withdrawn. A limited partner has no power to bind the firm and cannot take part in the management of the firm, which is left to the general partners. If he does so he will become liable for all the firm's debts during that time. There is no objection, however, to a limited partner advising his partners and he may inspect the firm's books and examine into the state and prospects of the partnership business. His death does not dissolve the partnership nor is his bankruptcy or lunacy a ground for dissolution. A limited partner has no right to dissolve the partnership by notice. A partner who is not a limited partner is a general partner and general partners alone have the right to manage the firm and their liability for the firm's debts and obligations is unlimited.

A limited partnership firm must be *registered* with the Registrar of Joint Stock Companies stating, the firm name, the general nature of the business, the principal place of business, the full name of each partner and the term, if any, for which the partnership is entered into with the date of its commencement, that the partnership is limited distinguishing between limited and unlimited partners, and the sum contributed by each limited partner and whether paid in cash or otherwise. Every change in the above particulars must also be notified to the Registrar.

There are very few limited partnerships because although a limited partnership has some similarity to a private limited company, it does not have many of its advantages.

SUMMARY

Definition: "Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all," (S. 4).

Illegal Partnership: The maximum number of partners is ten in the case of a banking business and twenty in the case of any other business. Therefore when a firm exceeds such maximum it is an illegal association.

Essentials of Partnership:

- (1) An agreement.
- (2) Two or more persons.
- (3) Sharing of profits.
- (4) Existence of a business.
- (5) Relationship of principal and agent.

Partnership	Firm
1. Abstract relationship between members of firm.	1. Collective term for partners.
2. Dissolution of partnership means end of legal relationship between some or all partners.	2. Dissolution of firm means end of relationship among all partners.

Partnership Distinguished from Other Similar Association

Partnership	Co-ownership
1. Always arise from agreement.	1. May arise from agreement or by operation of law e.g. through inheritance.
2. Each partner is the agent of the others.	2. A co-owner is not an agent of the other owners.
3. A business is essential.	3. Co-ownership may exist without a business e.g. joint ownership of land.
4. Sharing of profits is essential.	4. Sharing of profits is not essential.
5. A partner must get the consent of his co-partners before transferring his position as partner.	5. A co-owner does not need the consent of the other owners for a transfer of his interest.
6. A partner has a lien on the partnership property for payments made by him for the partnership.	6. A co-owner has no such lien.

Partnership	Joint Hindu Family Firm
1. The Partnership Act applies	1. The Hindu law applies.

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| <p>2. Membership arises out of an agreement.</p> <p>3. As there is the relationship of principal and agent among partners, each partner has implied authority to bind the firm by his actions.</p> <p>4. Every partner has unlimited liability for the debts of the firm.</p> <p>5. Minors cannot be partners.</p> <p>6. The death of a partner dissolves the firm unless there is an agreement to the contrary.</p> <p>7. A partner can ask for an account of past profits when he severs his connection with the firm.</p> | <p>2. Membership arises as a result of status, i.e. being born in a joint Hindu family with an ancestral business.</p> <p>3. Only the <i>Karta</i> or manager has authority to bind the joint family firm.</p> <p>4. Only the <i>Karta</i> has unlimited liability.</p> <p>5. Minors become members at birth.</p> <p>6. The death of a co-parcener does not dissolve the firm.</p> <p>7. A co-parcener cannot ask for an account of past profits.</p> |
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Partnership

Club

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| <p>1. A business.</p> <p>2. Purpose-sharing of profits.</p> <p>3. Partners are responsible for firm's debts.</p> <p>4. Partner is agent of firm.</p> <p>5. Death of partner dissolves firm.</p> | <p>1. Not a business.</p> <p>2. Purpose-social.</p> <p>3. Members are not responsible for debts of club.</p> <p>4. Member is not agent of club.</p> <p>5. Death of member does not dissolve club.</p> |
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Rights and Duties of Partners: Each partner has the same rights and duties but these can be varied by agreement. The following rights and duties are therefore, subject to the partnership agreement.

Rights & Powers

- (1) To take part in the conduct of the business.
- (2) To be consulted before any decision is taken by the majority relating to differences that may arise in ordinary matters connected with the business.
- (3) To prevent any change in the nature of the business being made without his consent.
- (4) To have access to and to inspect and copy any of the books of the firm.
- (5) To share equally in the profits of the business.
- (6) To interest at 6 per cent per annum on any advance beyond the amount of his capital contribution.

- (7) To be indemnified by the firm for payments made and liabilities incurred by him—
 - (a) in the ordinary and proper conduct of the business, and
 - (b) in an emergency, for protecting the firm from loss.
- (8) To act as the firm's agent.

Duties and Obligations

- (1) To carry on the business of the firm to the greatest common advantage.
- (2) To be just and faithful to other partners.
- (3) To render true accounts and full information, of all things affecting the firm, to any partner or his legal representative.
- (4) To attend diligently to the business of the firm.
- (5) To indemnify the firm for loss caused by his fraud or wilful neglect.
- (6) To contribute equally to the losses of the firm.
- (7) To be liable jointly and severally for the debts of the firm.

Express Authority

When the power of a partner to bind the firm is given by agreement or otherwise expressed in words spoken or written.

Implied Authority

To do what is necessary
 (a) to carry on the business in the usual way.
 (b) to protect the firm from loss in the case of an emergency.

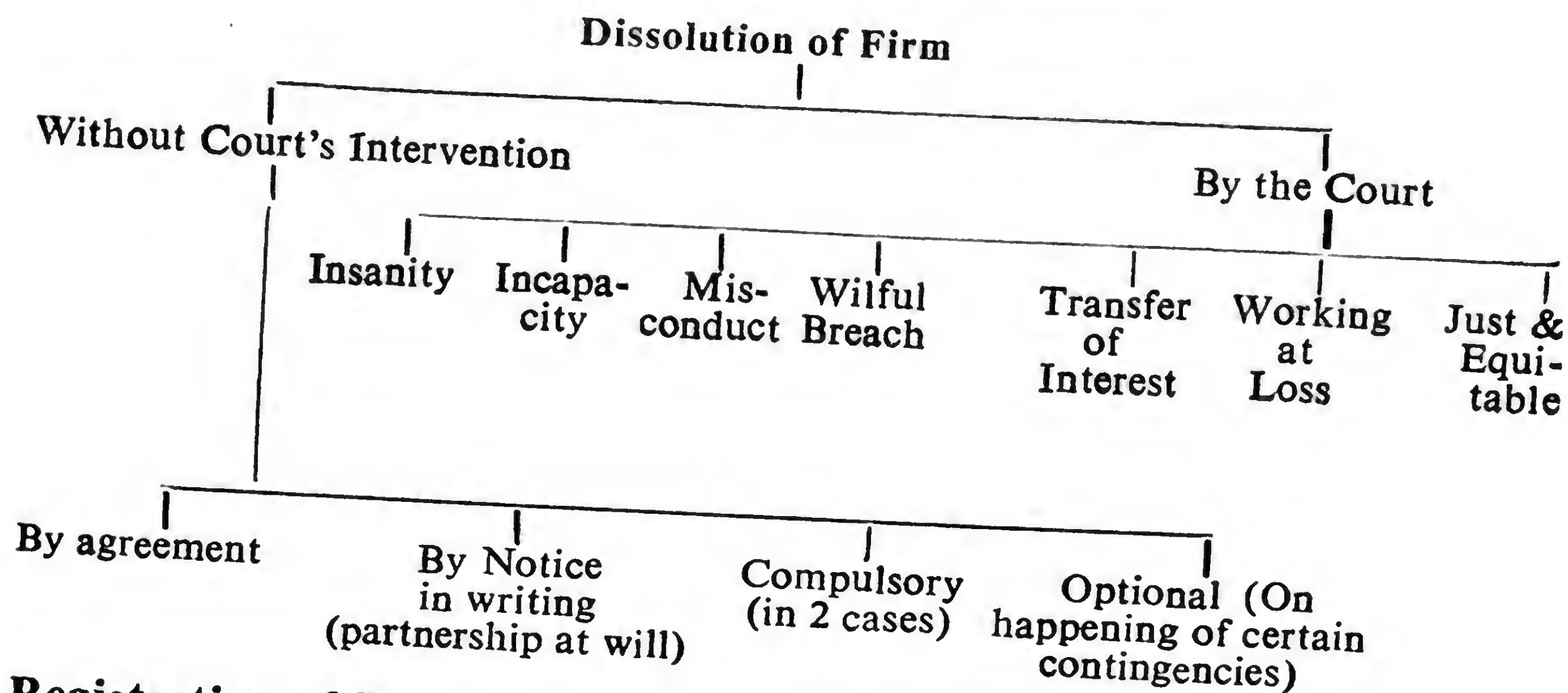
Restrictions on Implied Authority: In the absence of any usage or custom of trade to the contrary, a partner has **no implied authority** to do the following:—

- (1) submit a dispute relating to the business of the firm to arbitration;
- (2) open a banking account on behalf of the firm in his own name;
- (3) compromise or relinquish any claim or portion of a claim by the firm;
- (4) withdraw a suit or proceeding filed on behalf of the firm;
- (5) admit any liability in a suit or proceeding against the firm;
- (6) acquire immovable property on behalf of the firm;
- (7) transfer immovable property belonging to the firm; or
- (8) enter into partnership on behalf of the firm.

Types of Partners

- (1) **Active Partner:** one who takes part in the conduct of the business. He is liable to outsiders for the debts of the firm.
- (2) **Dormant or Sleeping Partner:** one who does not take part in the conduct of the business but who shares in the profits. He is liable to outsiders for the debts of the firm.

- (3) **Nominal Partner:** one who merely lends his name to the firm. He is liable to outsiders for the debts of the firm.
- (4) **Partner by Holding Out or Estoppel:** one who either by words or conduct represents himself to be a partner in the firm. He will be liable as a partner to those who give credit to the firm on the faith of such representation.
- (5) **Sub-Partner:** one who is not a partner of the firm but whom one of the partners has agreed to give a share of his profits from the firm. Not being a partner, a sub-partner is not liable for the debts of the firm.
- (6) **Minor Partner:** he is not a partner and therefore not personally liable for the debts of the firm, but only to the extent of his share in the profits and property of the firm.



Registration of Firm: Registration is optional, not compulsory.

Effects of Non-Registration

- (1) An unregistered firm cannot enforce any contractual rights against third parties.
- (2) Partners of an unregistered firm cannot sue in their own names to enforce any contractual rights of the firm against third parties.
- (3) A partner cannot recover any amount due to him by the firm or by his other partners.
- (4) A partner cannot enforce any right under the Partnership Act but he may sue: (a) for a dissolution of the firm, (b) for accounts and for his share of profits on dissolution, (c) for realisation of the property of the firm.
- (5) Neither a partner nor the firm can claim a counter-claim or set-off when sued by a third party.

Non-registration, however, does not affect the rights of a third party to take legal proceedings against an unregistered firm or its

partners. It does not also affect the rights of the official assignee of an insolvent partner to recover the property.

TYPICAL QUESTIONS

1. (a) *X*, a partner of a firm dealing in stationery, offers to sell to your bank a building belonging to the firm. What steps would you take before accepting the offer?
 (b) What is required to make an instrument executed by a partner on behalf of his firm binding on the firm?
2. (a) What are the rights and liabilities of a minor who is allowed to participate in a partnership firm?
 (b) What are the provisions in the Partnership Act regarding registration of a partnership firm?
3. Explain the grounds on which a firm may be dissolved by the Court. What are the mutual rights and obligations of the partners after dissolution? How are accounts settled between them after dissolution?
4. How would you determine whether a group of persons does or does not constitute a partnership?
5. (a) Explain clearly the nature and extent of the authority of a partner in a firm.
 (b) *A*, *B* and *C* enter into a partnership agreement under which *C* is not liable for losses. *D* files a suit against *A*, *B* and *C*. Examine the position of *C*.
6. (a) What is the effect of non-registration of a partnership firm?
 (b) What is the doctrine of holding out? Has it any connection with estoppel? State clearly the conditions necessary to make a person liable as a partner by holding out.
 (c) *A*, *B* and *C* carried on business for profit, but under very special conditions as to *C*, that *C* was to contribute neither labour nor money, and not to receive any profits, but to lend to the firm his name. Is *C* liable as a partner to third parties? Why?
7. *M*, stating that he was a partner of *G & Co.*, entered into a contract with *K* for purchase of electrical appliances at a cost of Rs 20,000 and obtained delivery of the goods. *M* is insolvent. What are the rights of *K* against *G & Co.*?
8. How far is it true to say that the law of partnership is an extension of the law relating to principal and agent? Explain the doctrine of holding out in reference to the relation of partners to the third parties.
9. Define Partnership, what are the rights, duties and liabilities of Partners *inter-se*?
10. Write short notes on any three of the following:—
 1. Property of firm
 2. Partner by holding out
 3. Implied authority of a partner

4. Resale by an unpaid seller
 5. Dissolution by court
 6. Expulsion of a partner.
11. What are the provisions of the Indian Partnership Act in respect of
- (a) 1. Introduction of a partner,
2. Expulsion of a partner.
 - (b) What are the rights and liabilities of an outgoing partner?
12. Write short notes on any three of the following:—
1. Definition of Partnership
 2. Compulsory dissolution
 3. Partnership by estoppel
 4. Partnership at will.
 5. Rights of outgoing partner.
13. Discuss the tests for determining the existence of a partnership.
14. State the different grounds on which a firm may be dissolved by a court.
15. Write short notes on any three of the following:—
1. Insolvency of Partner
 2. Goodwill of a firm
 3. Retirement of Partner
 4. Effects of non-registration
 5. Minor's rights under Indian Partnership Act.

Chapter 16

SALE OF GOODS

THE INDIAN Sale of Goods Act of 1930 came into force on March 15, 1930. It more or less followed the English model and repealed Chapter VII of the Contract Act of 1872, which dealt with sale of goods.

Goods

“*Goods*” are *defined* by the Act as “every kind of movable property other than actionable claims and money; and include stock and shares, growing crops, grass, and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale”.

An *actionable claim* is one which can be enforced only by taking action in Court, e.g. a debt.

“*Specific goods*” means “goods identified and agreed upon at the time a contract of sale is made”.

From the above definition we can see that the Indian Sale of Goods Act does not deal with immovable property or with actionable claims, but only with “goods”. The Transfer of Property Act provides for the transfer of immovable property and actionable claims.

Sale and Agreement to Sell

A *contract of sale* is defined as follows:—

“A contract of sale of goods is a contract whereby the seller transfers or agrees to *transfer* the property in goods to the buyer for a *price*. There may be a contract of sale between one part-owner and another” [S. 4 (1)]. “A contract of sale may be *absolute or conditional*” [S. 4 (2)].

The *difference between a sale and an agreement to sell* is pointed out in Section 4 (3) & (4) of the Act—

“Where under a contract of sale the property in the goods is transferred from the seller to the buyer, the contract is called a sale, but where the transfer of the property in the goods is to take place at a future time or subject to some condition thereafter to be fulfilled the contract is called an agreement to sell” [S. 4 (3)]. “An agreement to sell becomes a sale when the time elapses or the conditions are fulfilled, subject to which the property in the goods is transferred” [S. 4 (4)].

Thus the main distinction between a sale and a mere agreement to sell is the passing or transfer of property, *i.e.* ownership. If it is a sale, the property passes; if it is only an agreement to sell, the property or ownership is not transferred but merely agreed to be transferred later subject to certain conditions being fulfilled.

Sale and Bailment

The *difference between a sale and a bailment* is that in the case of a sale, the delivery of the article is made against a price in money, and that the identical thing is not to be returned. In other words, a transfer of property for money, or some other valuable in exchange, is a sale and not a bailment. In the case of a bailment the identical property which is the *subject-matter of the bailment* is to be returned to the bailor.

Sale and Contract for Work and Labour

A contract for the sale of goods must be distinguished from a contract for work and labour where no goods are sold but only some work is done.

ILLUSTRATION

An artist who paints a portrait for consideration with his own canvas and paints is selling goods but if he has merely painted the picture with materials supplied by his customer he has not sold goods but rendered work and labour.

Instalment Sale and Hire Purchase Agreement

An instalment sale must be distinguished from a hire purchase agreement.

ILLUSTRATION

Where *A* hires a sewing machine agreeing to pay a fixed amount of rent for the use of the machine, with a stipulation that should *A* pay a certain amount in cash at any time during the hire, he shall become the purchaser of the machine, provided he had regularly paid the rent; such an agreement is only an agreement for hire and *A* does not become a purchaser until the conditions as stated above are fulfilled.¹

The main principle to be noted in *hire purchase agreements* is that the purchaser has the option to pay a certain number of rents and only after he pays the stipulated number does he become the owner of the property. Moreover he is quite free to stop paying the rent and to return the property hired at any time he likes because *the property does not pass until the last rent is paid*²

ILLUSTRATION

A hires a piano to *B* on the agreement that *B* should pay Rs 100 a month as rent. A further stipulation is that if he pays rent regularly for twenty months, the piano shall become his property at the end of the twenty months, but if *B* likes he may return the piano at any time, say after using it for two months, and need not pay any more rent. This is a hire and purchase agreement proper.

If, however, it is agreed that twenty months' rent must be paid and that he cannot return the property, the agreement is a sale, not hire and purchase.³ Such a sale is better known as *a sale on the instalment system* and here the *property passes immediately* on the completion of the agreement whether any or all the instalments are paid or not.

In England, the Hire Purchase Act, 1964 which applies to agreements where the hire-purchase price is less than £ 2,000 has introduced many safeguards for the protection of the consumer.

Barter

A sale must be an exchange of goods for cash, that is for a price. The price is the payment made in money for the goods purchased. An *exchange of goods for goods* is not a sale but a barter. According to Lord Blackburn, the legal effects of a contract of sale and a barter are the same.

¹ *Gopal Tukaram v. Sorabji Nassarwanji* (1904), 6 Bom. L.R. 871

Helby v. Mathews (1895), 64 L.J.Q.B. 465

² There is an essential condition in a hire-purchase agreement because if this condition is not included, the agreement will be one of sale even though it may be described as a hire-purchase agreement. (*Bhimji v. Bombay Trust Corporation* 32 Bom. L. R. 64)

³ *Cecil Cole v. Nanalal Morarji*, 49 Bom. 172

Contract of Sale

A contract of sale is made by an *offer* to buy or sell goods for a price and the *acceptance* of such an offer. Delivery may be either immediate or future and payment may be either in cash or at some future date or in instalments. The actual contract of sale may be made either in writing or by word of mouth or partly in writing and partly by word of mouth [S. 5]. *Writing*, includes printing, lithography, photography and other modes of representing or reproducing words.

Formerly in *English Law*, under Section 4 of the Sale of Goods Act of 1893 contracts for the sale of goods for £ 10 or over were required to be supported by writing unless there was a part payment of the price or part delivery of the goods but now, since the passing of the Law Reform (Enforcement of Contracts) Act, 1954, writing is no longer necessary.

Ascertained and Unascertained Goods

The exact definition of ascertained goods is not given by the Act, but they are more or less on the same footing as *specific goods* though the word "ascertained" is really of a wider import. Considering all the authorities *ascertained goods are those goods which are in a deliverable condition at the time of sale or are put in a deliverable condition after sale and unconditionally appropriated to the contract and the buyer or his agent assents to the said appropriation or notice of the said appropriation has been given to him.*

When the *sale is of unascertained goods*, no property in the goods is transferred to the buyer unless and until the goods are ascertained (S. 18). If, however, the *sale is of specific or ascertained goods* the property in the goods is transferred to the buyer at such time as the parties to the contract intended it to be transferred. To ascertain this intention, regard should be had to the *terms* of the contract, the *conduct* of the parties and the *circumstances* of the case (S. 19). When there is an *unconditional contract for the sale of specific goods in a deliverable state*, the property passes immediately to the buyers on the contract being made, even though the time of payment of the price or the time of delivery of the goods, or both, are postponed (S. 20). When in a contract for specific goods the seller is bound to *do something with the goods for the purpose of putting them in a deliverable state*, the property does not pass until such thing is done and the buyer has notice thereof (S. 21).

ILLUSTRATION

If it is agreed between *A* and a motor car dealer that a car is to be painted blue before delivery, the car does not become an ascertained article until the manufacturer has done what he was asked to do. On the same principle, if *A* were to buy five tons of coal out of a warehouse where a large quantity was stored, the goods would not be ascertained until the five tons bought by *A* were weighed out and laid aside as goods to be taken delivery of by *A*. *The same rule will apply where in the case of specific goods the seller is bound to weigh, measure, test or do some other act with reference to the goods for the purpose of ascertaining the price* (S. 22). For example, if *A* sells a specific lot of coal, but it has to be weighed with a view to ascertain the price at, say Rs 100 per ton, until the said lot is weighed, the price ascertained and the buyer informed of it, the property does not pass.

The importance of finding out the exact moment of time at which the property (*i.e.* ownership) passes from the seller to the buyer, lies in the fact that *the moment the property passes to the buyer, the risk in the goods is generally transferred to the buyer*. Thus even though the goods remain after that event in the hands of the seller, and are destroyed by some accident, the buyer has to bear the loss and not the seller.

ILLUSTRATION

Where *A* brought a horse from *B* and requested *B* to keep it in his (*B*'s) stable until the next day and in the interval the horse was accidentally killed by a fire which broke out in *B*'s stable, the loss fell on the buyer, *A*.

In the case of *unascertained or future goods by description* when sold, the rule is that as soon as such goods are acquired by the seller, put in a deliverable state and unconditionally appropriated to the contract with the assent of the buyer, the property in these goods also passes to the buyer. The assent of the buyer may be either express or implied or may be given either before or after the appropriation is made. On the same principle, when the seller delivers the goods to the buyer, or to a carrier or a bailee, for the purpose of transmission to the buyer and does not reserve the right of disposal, he is deemed to have unconditionally appropriated the goods to the contract (S. 23).

The four requirements or *conditions precedent* here, in order to make the property pass from the seller to the buyer, are that—

- (1) The goods correspond with their description in the contract.
- (2) They are put in a deliverable state.
- (3) They are unconditionally appropriated to the contract.
- (4) Both the parties to the contract consent to the appropriation either expressly or impliedly.

An *appropriation* means specifying the goods to which the contract is attached.

Goods on Sale or Return

When goods are handed over to a prospective buyer on *approval*, or "on sale or return" or other similar terms, the implied contract is that the sale will be complete and the property will pass.

(1) at the moment of time when the prospective buyer signifies his approval or acceptance of the goods to the seller, or

(2) When the said party does any act adopting the transaction, or

(3) retains the goods beyond the time fixed or for an unreasonable time without giving to the owner of the goods a notice of rejection (S. 24).

Reservation of Right of Disposal

Let us suppose that there is a contract for the sale of specific goods or of goods that are subsequently appropriated to the contract, but there is a *term* in the contract by which it is laid down that the seller has reserved the right of disposal of the goods until certain conditions are fulfilled. In such a case, notwithstanding that the goods are delivered to the buyer or to a carrier or other bailee for the purpose of transmission to the buyer the property in the goods does not pass to the buyer until the conditions imposed by the seller are fulfilled.

The seller is *prima facie* deemed to have reserved a right of disposal also where the goods are shipped and the bill of lading lays down that the goods are deliverable to the order of the seller or his agent.

The other point emphasized by this section is that where the condition of sale lays down that a bill of exchange should be accepted, the buyer is bound to return the bill of lading if he does not honour the bill of exchange. If he wrongfully retains the bill of lading, the property in the goods does not pass to the buyer (S. 25). In this connection it may also be noted that there is no distinction drawn between a bill of lading or a carrier's or a wharfinger's receipt, or any other document of title to the goods.

Passing of Risk

The risk generally passes with the property "*res perit domino*", but the parties may provide by agreement that the risk may pass at some other time either before or after the passing of property or on some other condition. This is clear from Section 26 which begins

with the words, "unless otherwise agreed", and provides that risk *prima facie* passes with the property. The provisos to Section 26 gives two exceptions to that rule—

(1) If delivery has been delayed through the fault of either buyer or seller, the goods are at the risk of the party in default as regards any loss which might not have occurred but for such fault.

(2) The duties and liabilities of either the seller or the buyer as the bailee of the goods of the other party are not affected by the rule.

Price

Price is defined as "*money consideration for a sale of goods*" [S. 2 (10)]. This price may be fixed by the contract or may be left to be fixed in any manner specified in the contract. Failing that, the buyer is bound to pay the seller a *reasonable price*. What is a reasonable price is a question of fact depending upon the circumstances of the particular case. The course of dealing between the two parties may frequently determine the price (S. 9).

If the price is to be determined by the valuation of a third party and the third party cannot or does not make such valuation, the agreement is void. If, however, the said third party is prevented from making the valuation by the fault of the seller or of the buyer, the party not in fault can obtain damages against the party who is in fault (S. 10). Unless otherwise agreed, payment of the price and delivery of the goods are concurrent conditions (S. 32).

DELIVERY

Delivery is defined by Section 2 as meaning the *voluntary transfer of possession from one person to another*. Of course before delivery can be made the goods should be in a *deliverable state*, i.e. ascertained. Delivery may be *actual* where there is actual handling over of the goods, or it may be *constructive*, where there is a transfer of control over possession e.g. handing over of the key of the warehouse where the goods are kept and thereby giving possession of the goods to the buyer. *Constructive* delivery takes place when the goods are in the possession of a third party, and that third party agrees to hold them on behalf of the buyer. The mere giving of a delivery order to the buyer will not constitute delivery, until the person holding the goods and against whom the delivery order is made, agrees to put the buyer into possession.

According to mercantile practice, *constructive* or *symbolic deliveries*, or transfers, are also effected through the transfer of documents of title such as bills of lading, warehouse-keeper's certificates, dock warrants, or by the giving of the key of the godown in order that the buyer may obtain the goods. If delivery is to be made at a distant place, the usual loss caused through wear and tear on the journey and not through neglect on the part of the seller has to be borne by the buyer. In short, delivery of goods sold may be made by *doing anything which the parties agree shall be treated as delivery or which has the effect of putting the goods in the possession of the buyer* or of any person authorised to hold them on his behalf (S. 33).

Place and Time of Delivery

It is the duty of the seller to deliver the goods and of the buyer to accept and pay for them, in accordance with the terms of the contract of sale (S. 31). Apart from any express contract, the seller of goods is not bound to deliver them until the buyer applies for delivery (S. 35). In the absence of a contract the goods are implied to be taken delivery of *at the place* at which they are at the time of the sale, or in the case of goods agreed to be sold at a future date, they are implied to be taken delivery of at the place at which they are at the time of the agreement to sell, and, if they are not in existence at that time, at the place at which they are manufactured or produced. If the goods happen to be in the hands of a third party, there is no delivery by the seller to the buyer unless the third party acknowledges to the buyer that he holds the goods on his (the buyer's) behalf. The delivery should be demanded or tendered at a *reasonable hour*. What is a reasonable hour is a question of fact (S. 36).

Effect of part Delivery

Delivery of a part of the goods in process of delivery of the whole has the same effect for the purpose of passing the property in such goods as a delivery of the whole; but the delivery of a part of the goods with an *intention of severing* it from the whole does not operate as a delivery of the remainder (S. 34).

ILLUSTRATION

Where the goods arrive by a steamer in full quantity and the captain begins to dispose of the goods and gives delivery of part of the goods with the intention of delivering the whole, it is a good delivery. If, on the other hand, A sells to B a stock of firewood to be paid for by B on delivery, and soon after the sale B applies for and obtains from A leave to take away some of the firewood this has not the legal effect of delivery of the whole.

Delivery of Wrong Quantity

When delivery is given, the seller must deliver the *quantity agreed to be delivered* and if he delivers *less* than what he contracted to sell, the buyer may reject it. If the buyer accepts the goods so delivered, even in smaller quantities, he must pay at the contract rate for the quantity taken delivery of.

On the same principle, if the seller delivers *more* than he contracted to sell the buyer may either reject the whole or accept the quantity he agreed to buy and reject the balance (S. 37). The section further states that where there is a *mixed* delivery, *i.e.*, where the seller delivers to the buyer the goods he contracted to sell mixed with goods of a different description not included in the contract, the buyer may accept the goods which are in accordance with the contract and reject the rest, or may reject the whole.

Instalment Deliveries

If there is an agreement to deliver a fixed quantity, the buyer is not bound to accept delivery of the quantity by *instalments*. If, however, the agreement is to deliver against cash a certain quantity of goods in instalments, and if the buyer neglects or refuses to take delivery or pay for one or more instalments, it is a question in each case depending on the terms of the contract and the circumstances whether this failure would amount to a repudiation of the whole contracted or whether it is to be treated as a severable breach giving rise to a claim for compensation and not to a right to repudiate the contract (S. 38).

Delivery to Carrier or Wharfinger

When in pursuance of a contract of sale, a seller is authorized to send the goods to a buyer and the seller delivers the goods to a carrier, whether named by the buyer or not, to be transmitted to the buyer, it is *prima facie* deemed to be delivery of the goods to the buyer. It is, however, expected that the seller should make a proper contract with the carrier or wharfinger on behalf of the buyer which is reasonable having regard to the nature of the goods and the circumstances of the case otherwise if the goods are lost or damaged in the course of transit or when they are in the custody of a wharfinger, the buyer may decline to take delivery from the carrier or wharfinger as a delivery to himself or may hold the seller responsible for damages. In case the goods are to go by a route involving *sea transit* when in the usual course they have to be insured, the seller must give such notice to the buyer as may enable him to insure them

during their sea transit, and if he fails to do so, the goods shall be deemed to be at the risk of the seller during such transit (S. 39). This rule, of course, does not apply where goods are delivered to a carrier to be taken to a person who has a right to approve or return the goods, or on the footing of sale or return, because at the time they were sent there was no contract of sale. This section makes *prima facie* a wharfinger the agent of the buyer to take delivery in the case of a contract of sale. Even when the seller of the goods agrees or undertakes to deliver them at the buyer's place on his own risk the ordinary risk of deterioration in the goods incidental to the course of transit still remains on the buyer (S. 40).

Buyer's Right of Examining Goods

The *buyer has a right to examine the goods* and must have a *reasonable opportunity* of doing so for the purpose of ascertaining whether they are in conformity with the contract. The seller, therefore, is bound to give this reasonable opportunity (S. 41).

When the buyer has intimated to the seller that he has accepted the goods, or does any act in relation to the goods which is inconsistent with the ownership of the seller *i.e.*, offers to re-sell them or keeps them for an unreasonable time with him without intimating to the seller that he has rejected them, he is deemed to have accepted the goods (S. 42).

When the buyer *rightfully rejects* the goods, he is not bound to return them to the seller, but all that he need do is to intimate to the seller that he refuses to accept them (S. 43). This is on the principle that there is no reason why the burden of a situation caused by no fault of the buyer should be thrown on the buyer. Of course, when the seller offers delivery of the goods rightfully and the buyer does not take delivery within a reasonable time after such request, he is liable to the seller for the loss occasioned by his neglect or refusal to take delivery and he is also liable to pay a reasonable charge for the care and custody of the goods. This of course, does not affect the seller's right to treat the buyer's neglect or refusal to deliver as a repudiation of the contract (S. 44).

CONDITIONS AND WARRANTIES

In this connection the law, as embraced by our old Contract Act, was materially altered and brought into line with the English law. We shall now consider the various terms in a contract of sale and the legal effect of a breach of such terms. A stipulation in a contract

of sale may be either a condition or a warranty. A *condition* is defined as a *stipulation essential to the main purpose* of the contract, the breach of which gives rise to a *right to treat the contract as repudiated*. Thus a condition is so essential that if it is broken it gives rise to the opposite party to treat the contract as broken and to move for its remedy. To take an apt illustration, a condition is akin to one of the main pillars supporting a building. The breaking of any of these pillars results in the whole structure coming down. It may be added that the English Sale of Goods Act, from which we have mostly adapted our Indian Sale of Goods Act does not define "condition", though the case law has fully laid down its definition along the lines of our Sale of Goods Act, as mentioned above.

A condition may be (1) a *condition precedent*, viz. that which is to be fulfilled before the main purpose of the contract is to be performed. Thus if a person is appointed a trustee in bankruptcy on the condition that he should give security, the condition precedent here is the obligation imposed upon the trustee to give security before taking up the duties of his office; or (2) a *condition concurrent*, which means that it is to be performed at the same time as the principal or main agreement. Thus in case a sale is made cash against delivery, the condition of payment is concurrent with the performance of the contract; or (3) a *condition subsequent*, which means that the condition is that the fulfilment of the contract or the occurrence of an event, will discharge the parties from further liabilities on the contract, as for example, in case of a charter party, which is an agreement for hiring a ship, there is a clause, which is known as "expected risk", in which it is laid down that in the case of certain events occurring the shipowner will be discharged or released from the responsibility of performance of the contract. Here the event should occur subsequent to the entering into the contract and the moment it occurs the party is released from the obligation to perform the contract.

A warranty, on the other hand, is defined by this section as "*a stipulation collateral to the main purpose of the contract, the breach of which gives rise to an action for damages but not to a right to reject the goods and treat the contract as repudiated*". This definition strictly follows the English Sale of Goods Act, 1893. Thus a warranty may be compared to one of the small support chains running parallel to the big main chain, the snapping of any of which does not necessarily break the big chain. Here though the contract cannot be repudiated, the injured party may (1) sue the seller for damages as

compensation for the breach of warranty or (2) set up the breach of warranty to reduce or extinguish the price. Even if he has exercised his latter right in reduction or extinction of the price he may nevertheless sue for damages for the same breach of warranty if he has suffered further damages (S. 59).

Stipulation as to Time

Whether a stipulation is a condition or warranty will, of course, depend in each case on the construction of the term of the contract. A stipulation may be a condition, though called a warranty in the contract (S. 12). One point is certain, that a stipulation as to the *time of payment is not deemed to be of the essence* of a contract of sale, and whether any other stipulation as to time is of the essence of a contract or not depends on the terms of the contract (S. 11). Time is not regarded as of the essence of a contract for the sale of *immovable* property such as land or buildings, unless a different intention appears from the terms of the contract. In *mercantile contracts*, however, the law presumes that stipulations as to time, *other than time of payment*, are of the essence because it has been laid down, that when merchants mention the time and dates in their contract, they are taken to mean and intend that such stipulation should be strictly performed.

When Condition to be Treated as Warranty

Another important rule to be noted is that though a breach of condition gives rise in the case of a contract of sale to the right of the buyer to repudiate the contract, the buyer may, if he chooses, *waive the condition or elect to treat the breach of the condition as a breach of warranty and ask for compensation* [S. 13 (1)]. This is based on the general principle of the law of contract that a party may waive a stipulation which is for his own benefit.

Where a contract of sale is not severable and the buyer has accepted the goods or part thereof, or in the case of specific goods, the property which has passed to the buyer, the breach of any condition by the seller can only be treated as a breach of warranty and not as a ground for rejecting the goods and treating the contract as repudiated, unless there is a term of the contract, implied or express, to that effect [S. 13 (2)].

Implied Undertakings by Seller

In the case of the contract of sale, unless the circumstances show a different intention, there is an *implied condition* on the part of the seller that in the case of a sale, he has a right to sell the

goods and that, in the case of an agreement to sell, he will have a right to sell the goods at the time when the property is to pass.

There are also *implied warranties* that (1) the buyer shall have and enjoy *quiet possession* of the goods, and that (2) the goods shall be *free from any charge or encumbrance* in favour of any third party not declared or known to the buyer before or at the time when contract is made (S. 14).

An implied warranty or condition as to quality or fitness for a particular purpose may be annexed by the usage of trade [S. 16 (3)].

IMPLIED CONDITIONS

Sale by Description

Where there is a contract for the sale of goods by description, there is an implied condition that the goods shall correspond with the description; and if the sale is by sample as well as by description, it is not sufficient that the bulk of the goods corresponds with the sample if the goods do not also correspond with the description, (S. 15). This is because the description affects the very *nature* of the goods while the sample affects the *quality*. The fact that the buyer has seen or examined the goods does not prevent the sale being one by description if there is a latent defect in the goods. The place of origin of the goods may constitute a part of their description, e.g. Broach Cotton or Irish Linen. Lord Abinger's description in the case of *Chanter v. Hopkins*⁴ is very apt. He lays down that if a man offers to buy peas of another and the other sends him beans he does not fulfil the contract, and the action can be treated as a non-performance. Thus, according to the illustration in the old Contract Act, if A at Calcutta sells B "Waste Silk" then on its way from Murshidabad to Calcutta, there is an implied warranty that the silk shall be such as is known in the market as, "Waste Silk".

Implied Conditions as to Quality or Fitness

Where the buyer expressly or by implication makes known to the seller the particular purpose for which the goods are required *so as to show that the buyer relies on the seller's skill or judgement*, and the goods are of a description which it is in the course of the seller's business to supply, whether he is the manufacturer, or producer or not, there is an implied condition that the goods shall be reasonably fit for such purpose. Of course in the case of a sale of an article under its patent or trade name, it does not import this implied con-

⁴ (1838), 4 M. & W. 399

dition as to fitness [S. 16 (1)]. Supposing that *A* who has a boat of 100 tons calibre goes to *B*, who is a dealer in canvas, and asks for canvas in order to make a sail for his boat. If *B* supplies the canvas on being clearly told the specific purpose for which it is required, the sale carries an implied warranty that the canvas shall be fit for the purpose of being used in making a sail for a boat of 100 tons. Here the buyer has relied on the seller's skill. If, on the other hand, he selects the canvas without disclosing the purpose for which it is required, he does so on his own responsibility. In this case the general rule *caveat emptor* which means "buyer beware", applies. This rule under the Common Law of England lays down that in the case of a buyer who does not rely on the seller's skill, but who selects the goods himself, it is his own duty to see that the article he purchases is suitable for the purpose for which he wants it. In that case in the absence of any inquiry from the buyer, the seller is not bound to disclose the fact that it is not suitable for the buyer's purpose and the buyer buys the goods at his own risk. If *A* purchases a picture thinking that it is by a great artist, but without the seller making any such representation, he buys it at his own risk.

There is also a second exception to the rule of *caveat emptor*, viz., where goods are bought by description from a seller who deals in goods of that description (whether he be the manufacturer or producer or not), there is an implied condition that the goods shall be of merchantable quality [S. 16(2)]. Merchantable quality means that the goods must be saleable in the market as goods of that description. If, however, the buyer has examined the goods, there is no implied condition as regards defects which such examination ought to have revealed.

Sale by Sample

In the case of a sale by sample, i.e. where there is an agreement express or implied, that the goods are to be according to sample, there are the following implied conditions, that—

- (1) the bulk shall correspond with the sample in quality;
- (2) the buyer shall have a reasonable opportunity of comparing the bulk with the sample; and
- (3) the goods shall be free from any defects, rendering them unmerchantable, which would not be apparent on reasonable examination of the sample (S. 17).

Here if the defect be so hidden that it cannot be found out on reasonable examination, and the defect is of a nature that renders

the goods unmerchantable, the third warranty on a sale by sample would be broken, e.g. a manufacturer offered to sell a certain kind of shirting according to sample. This shirting was sized with china clay to a very large extent which was not apparent on a reasonable examination of the sample. The buyer ordered the goods on the footing of the sample and afterwards discovered the defect which rendered them unmerchantable; it was held that this amounted to a breach of warranty on the part of the seller. According to Lord Macnaughten:

“*The office of the sample is to present to the eye the real meaning and intention of the parties with regard to the subject-matter of the contract which, owing to the imperfection of language, it may be difficult or impossible to express in words. The sample speaks for itself. But it cannot be treated as saying more than such a sample would tell a merchant of the class to which the buyer belongs, using due care and diligence, and appealing to it in the ordinary way and with the knowledge possessed by merchants of that class at the time. Pulled to pieces and examined by unusual tests which curiosity or suspicion might suggest, it would doubtless reveal every secret of its construction. But that is not the way in which business is done in this country*”.⁵

With reference to contracts for the sale of goods which are to be shipped from a foreign port, various conditions are attached by the custom and practice of merchants. Some of the most common are F.O.B., F.O.R., F.A.S., C.I.F., and Ex-ship.

F.O.B., F.O.R., and F.A.S., Contracts

The letters *F.O.B.* stand for “Free on board” and according to Halsbury (Vol 25, p. 189), when the goods are shipped by the seller on these terms, “*the risk prima facie attaches to the buyer on the shipment, whether the goods are at the time specific or unascertained*”. In *Stock v. Inglis*⁶, Brett, M. R., expressed himself as follows:

“Now if the goods dealt with by the contract were specific goods, it is not denied but that the words ‘free on board’, according to the general understanding of merchants, would mean more than merely that the shipper was to put them on board at his expense they would mean that he was to put them on board at his expense on account of the person for whom they were shipped; and in that case the goods so put on board under such a con-

⁵ *Drummond v. Van Ingen* (1887), 12 App. Cas. 297

⁶ (1884) 12 Q.B.D. 564, affirmed in 10 Ap. Cas. 263

tract would be at the risk of the buyer whether they were lost or not on the voyage". Proceeding further his Lordship lays down that "in case of these specific goods they are at the purchaser's risk even though the payment is not to be made on delivery on board, but at some other time and although the bill of lading is sent forward with documents attached with the condition that the goods are not to be delivered until the purchaser has either accepted the bills or paid cash".

With reference to *unascertained goods*, while laying down that the same rule applies, he says—

"Is there any mercantile or legal reason why a person should not agree to sell so much out of a bulk cargo on board or ex such a ship, upon the terms that if the cargo be lost, the loss shall fall upon the purchaser, and not upon the seller? I can see no reason why he should not and if such a contract can be made, and a contract to buy and sell a certain quantity ex ship, or ex-bulk, there is put in the terms 'free on board' one must, with regard to that contract, give some meaning to those words 'free on board'. What meaning can be given to them with regard to the unseparated part of the goods which is the subject-matter of the contract, but the same meaning as is given to those words with regard to goods attributed to the contract? What is there unreasonable or contrary to business or law in these words 'free on board', meaning in such a contract I sell you twenty tons out of fifty upon the terms that you shall pay such a price for those twenty, I paying the cost of the shipment, that is, 'free on board' and you bearing the risk whether they are lost or not? It does not seem to me that there is anything inconsistent with business or law that parties should make such a contract with regard to a portion of a cargo than that they should make it with regard to a whole cargo or with regard to a specific part of a cargo and therefore the only question which remains is whether this is such a contract".

Thus in an F.O.B. contract it is the seller's duty to deliver the goods on board free of expense to the buyer, that is, the seller pays the loading charges, and the risk passes to the buyer together with the property only when the goods are actually delivered on board. Another duty of the seller in such a contract is to give the buyer sufficient notice to enable him to insure the goods. The letters F.O.R. stand for "free on rail".

F.A.S. means “free alongside ship” and refers to contracts in which the seller is to deliver the goods alongside the ship free of expense to the buyer who then becomes liable for subsequent charges. In this case the seller must pay the dock charges.

C.I.F. or C.F.I. Contracts

Another form of contracts of sale are C.I.F. or C.F.I. contracts. Here the seller agrees to ship the goods at the port of shipment, procure the contract of affreightment under which the goods would be delivered at the destination, arrange for insurance and to tender these documents to the buyer in order to enable him to obtain delivery of the goods, if they arrive, or recover for their loss if they are lost. Against such a tender of the documents the buyer must be ready and willing to pay the price.⁷ According to Halsbury, Vol. 25. p. 211, *where the price is to include the freight and the insurance* or as it is said, on “C.F.I. or C.I.F. terms, the seller, as between himself and the buyer, is chargeable with the amount of the freight and the insurance charges, and the buyer, if he has been paid either of these charges, may take credit therefor”.

In a Bombay case⁸ Mulla, J., at p. 1069 laid down the incidents of this form of contract as follows:—

“A ‘C. I. F.’ contract is not a mere sale of documents. It is still a contract for the sale of goods, though it is to be performed by transfer of proper documents. The document must be tendered as soon as possible after the seller has destined the cargo to the buyer. If there is a mail, the seller must transmit the documents by mail. The contract is performed in fact, and the date of its performance is the date, when the documents would come forward, the seller making every reasonable effort to forward them. In case of non-delivery the contract is broken at the time when the document ought to have been tendered, and not when the goods arrive, and damages must be estimated accordingly. *The buyer is bound to pay on tender of shipping documents*, and he is not entitled to refuse payment until he is given an opportunity for inspecting the goods. The goods comprised in a ‘C. I. F.’ contract must also be covered by an effective policy of insurance, an open cover taken out by the seller protecting all goods shipped by him is not sufficient. The policy must be tendered even if the goods arrive safely”.

⁷ *Biddell Bros v. E. Clemens Horst Co.* (1911) 1 K.B. 214 at p. 220

⁸ *Steel Bros, and Co, v. Dayal Khatav and Co.*, 25 Bom. L.R. 1063

In one case, however⁹ where the contract was described as C.I.F. but there were various terms and conditions in the contract which conflicted with all the basic principles as described above of a C. I. F. contract, the court refused to treat it as a "normal C. I. F. contract". Here it was provided (1) that the property in the goods was to be deemed to have passed to the purchaser as soon as they were delivered to the shipping company, but the seller was to have a lien on the goods for his dues. (2) payment was to be made against the bill of lading or delivery order. (3) the purchasers were to undertake to clear the goods from the docks and that they should have no objection if the vendors elect to clear the goods. (4) payment was to be made seven days after the arrival of the steamer. These clauses were inconsistent with the normal requirements and regulations applying to C. I. F. contracts. From this decision it is clear that if merchants and businessmen desire that the contract should be treated on a purely C.I.F. basis, they should not encumber it with inconsistent clauses and conditions such as the above.

Ex-ship Contracts

In the case of an 'ex-ship' contract, the seller agrees to deliver the goods from a ship which has arrived at the port of delivery and therefore to pay the freight and other incidental charges to the ship-owner and to give the buyer a delivery order to enable him to obtain the goods on arrival. The risk passes to the buyer after the ship has arrived and a proper delivery order is given to him.¹⁰

Transfer of Title

The usual and ordinary rule is that the transfer of title to the goods can only be made either by the owner or by one who has the authority of the owner. This is based on the famous maxim *nemo dat quod non habet*. Thus where goods are sold by a person who is not the owner thereof and who does not sell them under the authority or with the consent of the owner, the buyer acquires no better title to the goods than what the seller had, unless the owner of the goods is by his conduct precluded from denying the seller's authority to sell. There is, however, one exception to this rule which applies to the case of a *mercantile agent*. Here, if a mercantile agent happens to be in possession of the goods or of documents of title to the goods, which possession he has obtained with the consent of the owner, then even if he sells the goods without the consent of the owner

⁹ *Mohanlal Kashinath v. Krishna Premji and Co.*, 30 Bom. L.R. 415

¹⁰ *Yang-tsze Insurance Association v. Luckmanji* (1918) A.C. 585-589

when acting under the ordinary course of business of a mercantile agent, he will give a good title. Of course, it is necessary here that the buyer should have acted in good faith and without notice at the time of the contract of sale, that he had no authority to sell (S. 27). A *mercantile agent* as defined by the Act means "a mercantile agent having in the customary course of business as such agent authority either to sell goods, or to consign goods for the purpose of sale, or to buy goods, or to raise money on the security of goods" (S. 2). This section follows the rule laid down in the English Factors Act, 1899, in almost the same language. Here it should be noted that even though the mercantile agent had not the consent of the owner to sell, his possession was through the consent of the owner.

Another case is where one *of the joint owners* of goods has the sole possession of them by permission of the other co-owners and an outside third party buys the goods from such a co-owner in good faith and without notice at the time of sale that the seller has no authority to sell (S. 28). The illustration given in the Contract Act makes this point clear. Where three joint Hindu Brothers, *A, B and C* owned certain cattle, and when two of them left the cattle in the possession of *A*, and *A* sold one of the cattle to *D* who purchased it *bonafide*, the ownership in that animal passed to *D*.

When the seller has obtained possession of the goods under a contract voidable at the option of the other party on the ground of coercion, fraud, misrepresentation or undue influence but the contract has not been rescinded at the time of the sale, the buyer acquires a good title to the goods, provided he buys them in good faith without notice of the seller's defect of title (S. 29).

If a seller *after having sold* goods, *continues in possession* of the goods or documents of title to them, and delivers or transfers the goods or documents of title under any pledge or disposition to any person receiving them in good faith and without notice of the previous sale, the effect in law as far as the innocent buyer or pledgee is concerned, is as if the delivery or transfer were expressly authorized by the owner of the goods. On the same footing, when a buyer *obtains possession* of goods with the consent of the seller and sells and delivers or transfers them to some innocent person either under a sale, pledge or other disposition, the person who receives them in good faith and without notice of any lien or any other right on such goods of the original sellers, has a good title (S.30).

To sum up, *besides the owner of the goods the following can sell and give a good title—*

- (a) A mercantile agent in possession of goods or documents of title with the consent of the owner;
- (b) Any one of the joint owners who has sole possession with the consent of the other owners;
- (c) Any person who has obtained possession under a contract voidable at the option of the other party, unless obtaining of such a possession amounted to an offence;
- (d) A seller who continues in possession after sale;
- (e) A buyer who has obtained, with the seller's consent, possession of the goods or the documents of title.

Provided, of course, that in all these cases the buyer buys them in good faith.

Market Overt

It may be added here that in *English Law* a fourth exception is provided for, viz., where the goods are brought on the market overt, unless the thief, in case they are stolen goods, is prosecuted to conviction, the innocent buyer on the market overt gets a good title.

A *market overt* is a place where goods are usually exposed for sale. In various countrysides markets are held on appointed days, whereas in large towns or cities the shops on main streets are markets overt after sunrise and before sunset. It has also been held in England that ground floors of shops but not upper floors would be markets overt.

In India no rule as to market overt prevails, in fact markets overt were never recognized here. In other words, in the eye of the law there are no markets overt in India. Even in England the rule of market overt has lost much of its importance.

RIGHTS OF UNPAID SELLER

The seller of goods is deemed to be an *unpaid seller* when (1) the whole of the price has not been paid or tendered, or (2) a bill of exchange or other negotiable instrument has been received as conditional payment and has been dishonoured (S. 45).

An unpaid seller has the following three rights, notwithstanding the fact of the property in the goods having passed to the buyer—

- (1) Lien.
- (2) Stoppage in transit (*in transit*), and
- (3) Resale.

Lien

An unpaid seller has a lien on goods sold *if he is in possession* of them by which he can refuse to part with them until payment or tender of the price, in cases where —

- (1) the goods have been sold without any stipulation as to credit; or
- (2) the goods have been sold on credit, but the term of credit has expired; or
- (3) the buyer becomes insolvent.

The lien may be exercised even though the seller is holding the goods as the agent or bailee for the buyer. When an unpaid seller has made part delivery of the goods, he may exercise his lien on the remainder of the goods in possession provided, of course, it can be shown that the part delivery has not been made under such circumstances as to show an agreement to waive the lien (S.48).

The lien is lost if—

- (1) The seller delivers the goods to a carrier or other bailee for the purpose of transmission to the buyer without reserving the right of disposal of the goods.
- (2) the possession of the goods is obtained lawfully by the buyer or his agent, or
- (3) the seller waives his lien.

This lien is not lost even where the seller has obtained a decree for the price of the goods (S. 49).

Stoppage in Transit

The second right of the unpaid seller is to stop the goods in transit. When the buyer of goods becomes insolvent the unpaid seller who had parted with the possession of the goods has the right of stopping them in transit, that is to say, he may resume possession of the goods *as long as they are in course of transit* and may retain them until payment or tender of the price (S. 50). These four conditions have to be fulfilled—

- (1) the seller is unpaid who has parted with possession,
- (2) the buyer has become *insolvent*,
- (3) the goods are still *in transit*, and
- (4) the seller has *reserved* to himself the right of disposal.

The goods are deemed to be *in course of transit* from the time when they are delivered to a carrier or other bailee for the purpose

of transmission to the buyer *until* the buyer or his agent takes delivery of them from such carrier or other bailee. The important question here is, from what moment of time the buyer or his agent obtained delivery of the goods from the carrier, or from what moment of time the carrier agreed to hold the goods as the agent of the buyer instead of the agent of the seller. In other words, if the buyer or his agent obtains delivery of the goods before their arrival at the destination the transit is at an end. If, however, the goods are rejected by the buyer and the carrier or other bailee continues in possession, the transit is not deemed to be at an end even though the goods have arrived at their destination. If the goods were placed on a ship which was chartered by the buyer, it would depend on the circumstances whether they are in the possession of the master as a carrier only or as an agent of the buyer. If the buyer demands delivery of the goods lawfully and the carrier wrongfully refuses to deliver them the transit has ended, and if part delivery of the goods has been given the seller can still stop the rest unless it can be shown that this part delivery was given under such circumstances as to show agreement to give up possession of the whole of the goods (S. 51). *S*

The *transit continues* so long as the goods are in the possession of the carrier, or are lying at any place in the course of transmission to the buyer, but have not yet come into the possession of the buyer, or any other person authorized by the buyer to take possession on his behalf. In short, the transit continues *as long as the carrier holds the goods as a carrier, and not as the agent of the buyer*. If, however, the conveyance in which the seller sends the goods belongs to the buyer and the seller hands over the goods to the person in charge of the conveyance on the buyer's request, the goods pass into the possession of the buyer.¹¹ Where, after the arrival of the goods at the appointed destination, the carrier or other bailee agrees to hold the goods on behalf of the buyer or his agent, the *transit is at an end*, even though the buyer may have employed the same carrier to take the goods to a different destination indicated by the buyer. The simple fact that the buyer appointed a particular carrier to bring the goods from the seller to him will not make that carrier the buyer's agent nor will it deprive the seller of his right of stoppage in transit. Again, if the buyer or his agent obtains delivery of the goods before their arrival at the appointed destination the *transit ends*. The seller, however, may annex terms to such delivery. He may also preserve his right of stoppage by making the goods deliverable to his order or assigns in the bill of lading. If however, the carrier or the bailee

¹¹ *Chotmans v. L.Y.R. Co.*, L.R. 2 Ch. 332

wrongly refuses to deliver the goods to the buyer or his agent the transit is considered to be at an end. But if the buyer rejects the goods and refuses to take delivery of them the transit is not at an end and until he takes possession, the right of stoppage continues.

With regard to the goods delivered by the seller on the buyer's ship the transit continues if the delivery is given to the buyer only *in his capacity as a carrier* and this will be indicated by the fact that the bills of lading are made out in the name of the seller or his assigns. If, however, the goods are delivered to a ship chartered by the buyer then if the terms of the charter-party clearly indicate that the buyer is a temporary owner of the ship under a demise thereof, the delivery of the goods on board the ship, will be a delivery to the buyer's agent, unless the seller has reserved the right of disposal; but if the terms of the charter-party do not make the charterer a temporary owner, the goods are in transit.

In one case the assignee of a bankrupt buyer went on board a vessel on which the goods were in transit to the buyer and touching the goods informed the captain that he had come to take possession of the goods, to which the captain did not agree. It was held that this did not come within the definition of "possession by the buyer or his agent" and therefore the right of stoppage in transit did not end.¹²

In another case¹³ Lord Ellenborough states that "the goods had so far gotten to the end of their journey, that they waited for new orders from the purchaser to put them again in motion, to communicate to them another substantive destination, and that without such orders they would continue stationary". This circumstance was considered by the learned judge as sufficient to mark the end of the transit.

To sum up, the position is this: When the goods are handed by the vendor to the carrier as his agent or bailee, the transit continues as long as such agent holds the goods on behalf of the vendor; but if the carrier holds as a carrier pure and simple, the vendor can exercise his right of stoppage until the goods are handed to the buyer or the buyer's agent, or until the carrier agrees to hold them as the buyer's agent. In the words of Lord Esher,¹⁴ "When the transit is a transit which has been caused either by the terms of the contract or by the directions of the purchaser to the vendor, the right of stoppage

¹² *Whitehead v. Anderson* (1842), 9 M and W.S. 18

¹³ *Dixon v. Baldwin*, 7 R.R. 681

¹⁴ *Bethell v. Clark*, 20 Q.B.D.

exists, but if the goods are not in the hands of the carrier by reason either of the terms of the contract, or of the directions of the purchaser to the vendor, but are in transit afterwards in consequence of fresh directions given by the purchaser for a new transit, then such transit is no part of the original transit and the right to stop is gone".

The transit, therefore, ends when—

(1) the buyer or his agent has actually taken physical or constructive possession, or

(2) when at the instance of the buyer they are ordered to a new destination after the original destination is reached.

Modes of Stoppage

The unpaid seller may exercise his right of stoppage in transit, either by—

(1) taking actual possession of the goods, or

(2) giving notice of his claim to the carrier or other bailee in whose possession the goods are (S. 52).

Such notice may be given either to the person in actual possession of the goods or to his principal. In the latter case the notice, to be effective, should be given at such time and in such circumstances that the principal, by the exercise of reasonable diligence, may communicate it to his servant or agent in time to prevent a delivery to the buyer. It is the duty of the carrier or other bailee who happen to be in possession of the goods to redeliver them to the seller or according to his directions. It is not the duty of the seller to prove to the carrier that the stoppage is justified by events because in law the unpaid seller stops the goods at his own peril. If the carrier, in spite of having received this notice in time, refuses to redeliver the goods to the seller he is guilty of a conversion of the goods.

Transfer by Buyer and Seller

It may happen that the buyer before the goods are stopped in transit, and anticipating receipt of them, has resold the goods. The unpaid seller is not here affected as far as his right of lien or stoppage in transit is concerned if he has not assented to this sale, unless he has issued a document of title to the goods to the buyer and the buyer has transferred the document to a person who takes it in good faith and for consideration. In this case, if the transfer was by way of sale, the unpaid seller's right of lien or stoppage in transit is defeated, but if the said transfer was made by way of pledge or other

disposition for value, the unpaid seller's rights of lien or stoppage in transit can only be exercised subject to the rights of the transferee. However, in this last case, if the pledgee has some other goods or securities of the buyer in his hands and available against the buyer, the unpaid seller may require the pledgee to be satisfied out of these other goods and securities in the first instance (S. 53). In other words, the unpaid seller can insist upon the pledgee marshalling the securities and exhausting them towards satisfying the claim before proceeding against the goods of the unpaid seller.

Resale

The third remedy of the unpaid seller is resale. Where the goods are of a *perishable nature* they may be resold immediately. If an unpaid seller who has exercised his right of lien or stoppage in transit, gives *notice to the buyer* of his intention to resell, and if the buyer does not within a reasonable time pay or tender the price, the unpaid seller may resell the goods within a reasonable time and recover from the original buyer damages for any loss occasioned by his breach of the contract. If the resale results in a profit, the buyer is not entitled to it. If the unpaid seller sells without notice, he will not be entitled to recover such damages from the buyer and the buyer will be entitled to the profit, if any, on the resale. The *buyer* who buys from the unpaid seller *of this resale gets a good title against the original buyer even if no notice of resale was given to the original buyer* [S. 54(1) to (3)].

Special Resale Clause

We have seen that ordinarily on a breach of contract for the sale of goods, the damages allowed to the seller are based on the difference between the contract price and the market price. The seller may, however, as is generally done in the case of indents, *reserve to himself a special power of sale on default* of the buyer, in which case he can sue for the difference between the contract price and the actual price realised at such sale and on the exercise of such a right of resale, the original contract is rescinded [S.54(4)]. Here the clause in the contract may provide that the seller can resell even without appropriation and such a clause would be valid and binding¹⁵.

It is a frequent practice among merchants in India to insert a special clause in the contract or indent, by which the seller is em-

¹⁵ *Anguilla and Co. v. Sassoon and Co.*, 39 Cal. 581; *Molle Schutte and Co. v. Lachmichand*, 25 Cal. 505.

powered to resell the goods on failure of the buyer to take delivery of the goods within the time specified and to recover the loss on such resale with interest from the buyer. In such case the seller is *entitled to resell even if the property in the goods has not passed* to the buyer. The *advantage* here is that the *actual loss on resale is recoverable*, whereas in cases of ordinary contract the breach entitles the seller to recover only the difference between the contract price and the market price and that too as on the date of the breach.

SUITS FOR PRICE OR DAMAGES

We have already seen above that certain conditions reserved in indent enable parties to file a suit for the price or the recovery of damages on the footing of the price at which the goods were sold. Section 55 now provides that *the seller may sue the buyer for the price of goods provided.*

(1) The *property in the goods has passed* to the buyer, and the buyer wrongfully neglects or refuses to pay for the goods according to the terms of the contract, and

(2) although the *property has not passed* and although the goods have not been appropriated to the contract, where the sale price is payable on a day fixed by the contract irrespective of delivery and the buyer wrongfully neglects or refuses to pay such price (S.55).

There was no corresponding section in the old Contract Act. It may further be noted that where the price is thus due and payable it becomes an ordinary debt, and *where the price is payable unconditionally on a fixed date*, the buyer must pay it on that day irrespective of the property passing to him and irrespective of delivery. In other words, *where the property has passed*, the seller has the option *either to sue for the price under Section 55 or to sue for damages for non-acceptance under Section 56.*

On a similar principle, where the seller wrongfully neglects or refuses to deliver the goods to the buyer, *the buyer has a right to sue for damages for non-delivery* (S.57). That is the usual right of a buyer in the case of all mercantile transactions unless the agreement is for delivering specific or ascertained goods and the Court in its discretion thinks fit to direct that the contract shall be *specially performed* (S.58). Of course, as far as pecuniary compensation can be fixed to settle the matter, the Court will not order specific performance.

Anticipatory Breach

Where either party to a contract of sale repudiates the contract before the date of delivery, the other may either treat the contract as subsisting and wait till the date of delivery, or he may treat the contract as rescinded and sue for damages for the breach (S.60). This rule lays down that it is at the option of the injured party either to move immediately for damages on the footing of the breach, or to wait for the day of performance and then sue the other party for all the consequences of non-performance. If the injured party elects to treat the contract as broken it is known as an *anticipatory breach* in which case the *measure of damages* is the difference between the contract price and the market price at the date when the contract ought to have been performed. If, however, he waits until the day of performance, he keeps the contract alive for the benefit of the other party as well as his own, and if the market moves in favour of the opposite party the opposite party can take free advantage of it.

Interest by way of Damages

In cases of breaches of contract in the absence of a contract to the contrary, the Court may award interest at such rate as it thinks fit on the amount of the price. This interest may be *either allowed to the seller or the buyer*. To the seller it will be allowed in a suit filed by him for the amount of the price, *from* the date of the *tender* of the goods or from the date on which the price was payable. To the buyer it will be allowed in a suit by him for the refund of the price in the case of a breach of the contract on the part of the seller, from the date on which the payment was made (S.61).

Sale by Auction

In the case of a sale by auction, the following rules apply according to Section 64:—

(1) Where goods are put up for sale in lots, each lot is *prima facie* deemed to be the subject of a separate contract of sale.

(2) The sale is complete when the auctioneer announces its completion by the fall of the hammer or in other customary manner; and until such announcement is made, any bidder may retract his bid.

(3) A right to bid may be reserved expressly by or on behalf of the seller and where such right is expressly so reserved but not otherwise, the seller or any one person on his behalf may, subject to the provisions hereinafter contained, bid at the auction.

(4) Where the sale is not notified to be subject to a right of the seller, it shall not be lawful for the seller to bid himself or to employ any person to bid at such sale or for the auctioneer knowingly to take any bid from the seller of any such person; and any sale contravening this rule may be treated as fraudulent by the buyer.

(5) The sale may be notified to be subject to a reserved or upset price.

(6) If the seller makes use of pretended bidding to raise the price, the sale is voidable at the option of the buyer.

SUMMARY

CONTRACT OF SALE

Sale

1. Ownership passes to the buyer.
2. If the goods are damaged or destroyed the buyer (being the owner) has to bear the risk (The risk passes with the property).

Sale

1. A transfer of ownership (property in goods).
2. Possession may or may not be transferred at the time of sale.
3. The buyer can do what he likes with the goods.
4. The goods *cannot* be returned after sale.

Sale

1. Governed by the Sale of Goods Act.

Agreement to Sell

1. Ownership remains with the seller.
2. The risk remains with the seller unless there is an agreement to the contrary.

Bailment

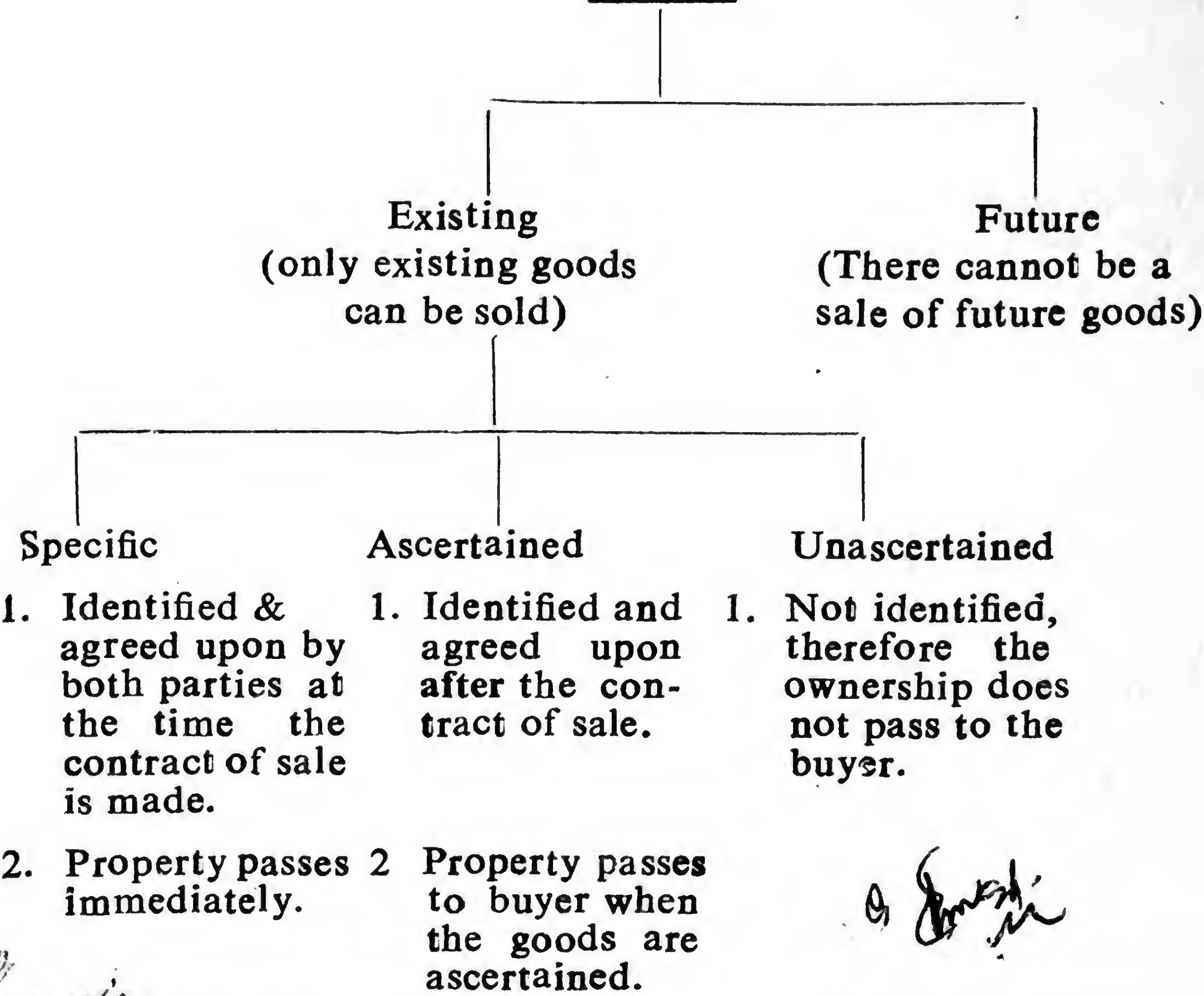
1. The ownership is not transferred; only possession is transferred.
2. Possession is delivered.
3. The bailee has to act in relation to the goods according to the directions of the bailor.
4. The goods *must* be returned after the purpose is over unless the bailor has given other instructions for their disposal.

Contract for Work and Material

1. Not governed by the Sale of Goods Act.

2. Transfer of title to goods.
2. Exercise of skill and labour in respect of materials supplied by another.

GOODS



Instalment Sale

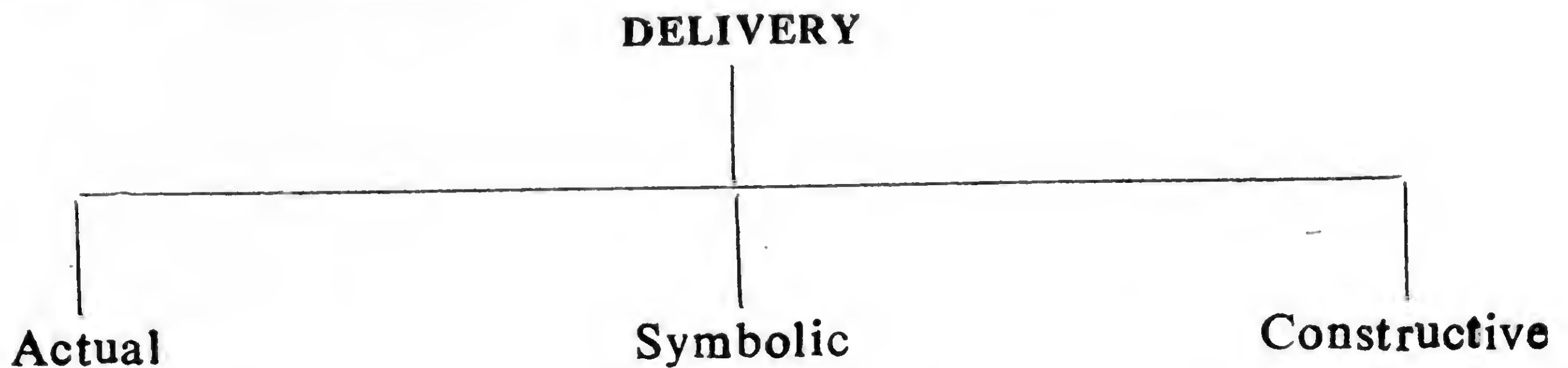
Hire-Purchase Agreement

- | | |
|---|--|
| 1. Ownership passes to the buyer. | 1. Ownership is not transferred until the last of the agreed number of payments has been made. |
| 2. The buyer becomes the owner. | 2. The hire-purchaser becomes a bailee. |
| 3. The buyer is bound to pay all the instalments and cannot terminate the contract. | 3. The hire-purchaser cannot be forced to pay all the instalment because he has an option to terminate the contract at any time. |
| 4. The instalments are treated as payments towards the price of the goods. | 4. The payments made by the hirer are regarded as rents or hire charges till he exercises his option to purchase the goods |

Sale**Barter**

1. Exchange of goods for a price in money.

1. Exchange of goods for goods.



Rules as to Delivery: In the absence of an agreement to the contrary the following rules will apply:—

- (1) Goods must be in a deliverable condition.
- (2) Payment of price and delivery of goods are concurrent conditions.
- (3) Delivery may be actual, symbolic or constructive.
- (4) It is the buyer's duty to apply for delivery.
- (5) Place of delivery is where the goods are at time of sale.
- (6) Time of delivery is a reasonable time.
- (7) Cost of making delivery is to be borne by the seller and of taking delivery by the buyer.
- (8) Quantity delivered should be according to the terms of the contract.
- (9) Delivery of wrong quantity entitles the buyer to reject the good.
- (10) Seller is not entitled to deliver by instalments because the contract must be performed as a whole and cannot be divided unilaterally.
- (11) Delivery to carrier or wharfinger is *prima facie* deemed to be delivery to the buyer.

Rights of Unpaid Seller

- (1) Against goods—
 - (a) lien
 - (b) stoppage in transit
 - (c) resale
- (2) Against buyer personally.
 - (a) suit for price
 - (b) suit for damages for non-acceptance
- (3) Suit for interest if there is an interest clause in the agreement.

TYPICAL QUESTIONS

1. Discuss the law relating to the passing of property in the case of—
 - (a) sale of goods on approval;
 - (b) sale of unascertained goods and their appropriation to the contract.
2. Explain the maxim *caveat emptor*. State the exceptions to it as laid down in the Indian Sale of Goods Act.
3. (a) State the rules governing the passing of title to goods from the seller to the purchaser.
 (b) What is the general rule about a purchaser of goods getting a better title to the goods than the seller, and what are the exceptions to the rule?
 (c) In what circumstances can a seller of goods stop the goods in transit?
4. (a) What is a contract for sale of goods by sample, and what is the implied condition attached to such contract?
 (b) State the rights which an unpaid seller of goods has by implication of law.
 (c) Distinguish between a condition and a warranty, in a contract of sale.
5. (a) Explain—
 “No man can give a better title than that which he himself has”.
 (b) Critically examine exceptions to this rule.
6. Write notes on any three—
 - (a) C. I. F. contracts.
 - (b) *Caveat emptor*.
 - (c) Reservation of right of disposal.
 - (d) Unpaid Seller's Lien.
 - (e) Mercantile Agent.
7. What are implied conditions in a sale of goods?
8. What is meant by an “unpaid seller”? What are his rights against.
 - (a) the goods; and
 - (b) the buyer personally?
9. (a) Distinguish between a sale and an agreement to sell.
 (b) State fully the various reasons why it is important to know when the property in goods agreed to be sold passes.
10. G (aged 6) bought a catapult from P and was injured by its defective condition. He claims damages from P on the grounds of (i) unfitness for purpose and (ii) not being of merchantable quality. Will he succeed?
11. H sold to W, by description, sulphuric acid “commercially free from arsenic”. H did not know nor was he told the purpose for which the acid was required but W in fact used it for making glucose, which he sold to brewers for the brewing of beer. The sulphuric acid was not commercially free from arsenic, and the beer was rendered poisonous. W became liable to the brewers for damages which they had to pay to their poisoned customers. On these facts has W any legal rights against H, and in particular can he recover from H damages which he has had to pay to the brewers and damages for injury to the goodwill of his own business?

Chapter 17

NEGOTIABLE INSTRUMENTS

THE LAW with regard to bills of exchange, cheques and promissory notes in India is governed by the *Negotiable Instruments Act, 1881*, and the sections quoted in this chapter refer to that Act. In England the law relating to such instruments is codified by the *Bills of Exchange Act* of 1882 and the *Cheques Act, 1957*.

History

This branch of law originally derived its authority from the *Law Merchant* which is an accumulation of the customs of trade which received the sanction of law through the decisions of judges. Cockburn, C.J., while speaking about the history of negotiable instruments in *Goodwin v. Roberts*, expressed himself as follows:—

“Bills of exchange are known to be of comparatively modern origin, having been first brought into use, so far as is at present known, by the Florentines in the twelfth, and by the Venetians about the thirteenth century. The use of them generally found its way into France, and still later, but slowly, into England. With the development of British commerce the use of these most convenient instruments of commercial traffic would, of course, increase,

according to Mr. Chitty, the earliest case on the subject to be found in the English books is that of *Martin v. Boure* in the reign of James I. Up to this time the practice of making these bills negotiable by endorsement has been unknown, and the earlier bills are bound to be made payable to a man and his assigns, though in some instances to bearer. But about this period. *i.e.*, at the close of the sixteenth or the commencement of the seventeenth century, the practice of making bills payable to order, and transferring them by endorsement took its rise. At first the use of bills of exchange seems to have been confined to foreign bills between English and foreign merchants. It was afterwards extended to domestic bills between traders, and finally to bills of persons whether traders or not".

Promissory notes also came into use almost at the same time but for a long time they were not treated as negotiable instruments. Lord Holt in the time of Queen Anne was much against these documents (promissory notes) being treated as negotiable, but in obedience to the force of mercantile opinion an Act was passed (Statutes 3 and 4 Anne, Ch. 9) by which the law was modified and promissory notes were declared negotiable.

Application of Act

The Negotiable Instruments Act does not apply to—

- (1) the Reserve Bank of India Act, 1934, Section 21. That section prohibits any person in India other than the Reserve Bank or the Central Government, to make, draw, accept or issue any bill of exchange, hundi, promissory note or engagement for the payment of money payable to bearer on demand, or borrow, owe or take up any sum or sums of money on bills, hundis or notes payable to bearer on demand of any such person, provided that cheques or drafts including hundis payable to bearer on demand or otherwise, may be drawn on a person's account with a bank, shroff or agent. The object of this provision is to protect the monopoly of the Government of issuing the paper currency of the country.
- (2) any local usage relating to any instrument in an oriental language, except so far as such usages are excluded by any words in the body of the instrument or where the intention is indicated to the effect that the legal relations of the parties to a particular class of instrument shall be governed by the Negotiable Instruments Act, (S.1.)

It may be added, therefore, that this Act primarily deals with bills of exchange, promissory notes and cheques. There may be other kinds of negotiable instruments to which it would apply in the absence of local usage to the contrary.

Definitions

Negotiable Instrument: Section 13 of The Negotiable Instruments Act, states as follows:—

(1) A “negotiable instrument” means a promissory note, bill of exchange or cheques payable either to order or to bearer.

Explanation (i) A promissory note, bill of exchange or cheque is payable to order which is expressed to be so payable or which is expressed to be payable to a particular person, and does not contain words prohibiting transfer or indicating an intention that it shall not be transferable.

Explanation (ii) A promissory note, bill of exchange or cheque is payable to bearer which is expressed to be so payable or in which the only or last indorsement is an indorsement in blank.

Explanation (iii) Where a promissory note, bill of exchange or cheques, either originally or by indorsement, is expressed to be payable to the order of the specified person, and not to him or his order, it is nevertheless payable to him or his order at his option.

(2) A negotiable instrument may be made payable to two or more payees jointly, or it may be made payable in the alternative to one or two, or one or more of several payees.

Judge Willis, in his work on Negotiable Instruments, *defines* a negotiable instrument as “one, the property in which is acquired by any one who takes it *bona fide*, and for value notwithstanding any defect in title of the person from whom he took it”. It would thus be seen that by “*negotiability*” is meant that not only is the instrument transferable by indorsement or delivery but, that the holder in due course of a bill, who has received it *bona fide* complete and regular on the face of it, before it was overdue, for value, and without any notice as to the defect in title of a previous holder, acquires a good title.

Bill of Exchange: A *bill of exchange* is a negotiable instrument and is defined as “an instrument in writing containing an *unconditional order*, signed by the maker, directing a certain person to pay *a certain* sum of money only to, or to the order of, a *certain person*, or to the bearer of the instrument” (S. 5).

Promissory Note: A *promissory note* is a negotiable instrument and is defined as an instrument in writing (not being a bank note or a currency note) containing an unconditional undertaking, signed by the maker, to pay a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument" (S.4).

Cheque: A *cheque* is a negotiable instrument and is defined as "a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand" (S. 6).

Peculiarities

From the above definitions, it will be noticed that a negotiable instrument must be in *writing*. It must also be *unconditional*. With regard to the expression "unconditional" the Act says that the "promise or order to pay is not 'conditional' within the meaning of Sections 4 and 5 by reason of the time for payment of the amount of *any instalment thereof* being expressed to be on the lapse of a certain period after the occurrence of a specified event, which according to the ordinary expectation of mankind, is certain to happen, although the time of its happening may be uncertain". As for example, if a bill is payable on the death of A, that event, according to the ordinary expectation of mankind, is certain to happen, and therefore, the bill would not be void on the ground of uncertainty. If, however, a bill is to be payable "on the marriage of A" it will be void on the ground of uncertainty because A might not marry at all. It should also be noted that a bill must contain an *order* to pay and not a mere request, therefore the words used must be imperative in effect. Another requirement is that it must be payable either *on demand* or at a *determinable future time*. The bill or note ought to be for a sum *certain*. With regard to this the Act says that the sum payable is certain within the meaning of Sections 4 and 5 although it includes future interest, or is payable at an indicated rate of exchange, or is according to the course of exchange and although the instrument provides that on default of payment of an instalment the balance unpaid shall become due. The order or promise must be to pay *money* and money only. The definition also requires that the person to whom the bill is payable ought to be a *specified person* or that the bill should be payable *to bearer*. With regard to this the Act lays down that the person should be taken as specified although he is misnamed, or is designated by description only.

The expression *or order* has, as far as bills of exchange are concerned, a peculiar meaning and must, as far as possible, be strictly

used in cases of instruments written in the English language, because doubt is thrown as to whether the use of other words would be construed as having a similar effect. The words "or assigns", "or agent", "or attorney", "or representative" would not be construed as having the same effect as the words "or order".

An instrument drawn as "*Pay only*" is *not negotiable*. Again where the indorsement on an instrument runs as "Pay A" and does not include the words "or order" or "or bearer" the bill is negotiable in spite of this omission. The same rules apply to Government promissory notes, as under the Indian Securities Act of 1886, Section 6, the Negotiable Instruments Act is applicable to them. In this case Government promissory notes had been stolen, indorsements forged thereon and sold. When the rightful owners claimed them from the holders it was found that some of the loans were renewed. The court held that *forgery gave no title* and that *Government promissory notes came under the Negotiable Instruments Act* and that the plaintiffs should hand back all the notes, including those renewed.

From what has been so far discussed it must not be thought that bills, promissory notes and cheques are the only negotiable instruments. Other *instruments* such as bank notes, bank drafts, dividend warrants, share warrants, scrips, bearer debentures and Treasury bills *also enjoy the privilege of being "negotiable" by the custom and usages of trades and markets*. Each case will be decided on its own merits. In other words, though our Negotiable Instruments Act no doubt deals only with bills, promissory notes and cheques, it by no means seeks to limit the number of negotiable instruments to these three documents; *the Law Merchant*, as interpreted by the course, is left entirely a free hand in the work of extending the privilege to other instruments.

Quasi-negotiable Instruments

Railway receipts, bills of lading and dock warrants are referred to as "*quasi-negotiable*" instruments because they can be transferred by endorsement and or delivery but they are *not* negotiable instruments as a *bona fide* transferee for value without notice does not get a title free of defects in the titles of former transferors. Similarly money orders, postal orders and share certificates are *not* negotiable instruments, neither is a mere I.O.U. unless it also contains words which make it a promissory note.

“Not Negotiable” Crossing

If a cheque or bill is crossed generally or specially bearing the words “not negotiable” or “payable to X only”, it shall not have, and shall not be capable of giving, a better title to the cheque than that which the person from whom he received it had. Such a cheque may be indorsed and transferred; but no subsequent holder receives a better title than the transferor even if he is an innocent holder for value without notice. This is generally done when the holder wishes to transmit the cheque or bill by post, or through some other medium by way of remittance, and wishes to protect himself from the risk of having to pay twice over in case it is stolen en route, and gets in the possession of some one who may be in a position to claim money on it as a “holder in due course for value”.

Negotiable Security a Conditional Payment

It may be noted that when a person gives a negotiable security *i.e.*, a bill or a promissory note, either by accepting, endorsing, or otherwise, to his creditor, it operates as a conditional payment only and not as a satisfaction of the debt, unless the parties agree to treat it as such. The usual presumption is that the giving of such an instrument is a conditional payment. A creditor can sue on the original consideration where a cheque, promissory note or bill of exchange was not accepted as a complete and unconditional satisfaction to his dues, as such an instrument is to be taken as a conditional payment and the dues of the creditor will be discharged only when the creditor receives the cash.

Forms of Promissory Notes and Inland and Foreign Bills

The simplest of these documents is a *promissory note*.

ILLUSTRATION

A borrows from B Rs 100 or owes him that money, he may give to B a promissory note, in which he promises to pay B Rs 100 on demand, or at some other future date, with or without interest, according to arrangement between them. The simplest form would be as follows:

56, Mahatma Ganahi Road, Bombay, 16th June 1979	
<div style="border: 1px solid black; width: 100px; height: 80px; margin: 0 auto;"></div> <p>Stamp</p>	<p>On demand (or at three months after date) I promise to pay Mr. B the sum of Rupees One Hundred only. Value received.</p>
<p>To Mr. B</p>	<p>Rs 100-00. (Sd.) A</p>

This instrument puts the debt in what is called a “tangible form”, and *B*, the holder of it, has not only the consolation of having a written acknowledgment of this debt, as well as an instrument which evidences an acknowledgment of the debt, but also, in case he is in want of money and the debt is not due (where it is to be paid after some time), he can raise money on this promissory note by discounting it with a bank, *i.e.*, selling it for its value less a charge made by the banker by way of discount, or transfer it to some other person to whom he (*B*) may be owing money.

Merely because a document is described as a promissory note, does not make it one. It must satisfy the statutory requirements. A document which does not contain an express promise to pay is not a promissory note. Mere mention of the date of maturity in a receipt cannot make it a promissory note. In *Ambalal Purshottamdas & Co. v. J. P. Dave*, it was observed that a document cannot be construed as a negotiable instrument where proof of succession is needed to entitle a person to the money specified therein. One of the basic tests is that the *payee or bearer must be certain*. Therefore the words “we as well as our successors are bound herewith to fulfil your dues whenever and wherever you or your successors ask or demand the said sum” were held as not satisfying the test of certainty of the payee and the instrument therefore cannot be a promissory note. However, in the same case it was pointed out that the mere fact that the promissory note is written on a page in an account book of the creditors and therefore could not be negotiated from hand to hand, does not make it illegal or any the less a promissory note.

The absence of the name of the payee would not render the promissory note invalid if the payee was known with certainty at execution. Where the payee was described as “son of P. C.” and the plaintiff who had lent money was the son of P. C. although not mentioned by name and the lender and the borrower knew it and although there were other sons of P. C. in existence it was held that the name must always be mentioned to make a promissory note valid is not sustainable in any modern Court of justice, equity and good conscience.¹

With regard to a *bill of exchange*, it may be an *inland* or a *foreign bill*. We shall first take a simple example of an *inland bill*.

¹ *Ponnuswami Chettiar v. P. Vellaimuthu Chettiar*, 70 Mad. L. W. 260, (1957) 1 Mad. L.J. 179; see also *Brijraj Sharan v. Raghunandan Sharan* (S) A.I.R. 1955 Raj 85 (D.R.)

ILLUSTRATION

A, a retailer, buys goods from *B*, a wholesale merchant for, say Rs 150. The arrangement is that *A* should have a credit for one month after the date of delivery of the goods and that a bill should pass between them. Therefore, *B*, when delivering goods to *A* presents an invoice for the goods he has sold and also a draft of *B* which has to be accepted by *A* and returned to *B*, which makes it a complete document. The draft as drawn would be in the following form.

56, Dr. D. Naoroji Road, Bombay, 20th July, 1979	
<div style="border: 1px solid black; width: 100px; height: 80px; margin: 0 auto; display: flex; align-items: center; justify-content: center;"> Stamp </div>	<p style="text-align: center;">One month after date pay me or my order the sum of Rupees One hundred and Fifty only, for value received.</p> <p style="text-align: center;"> <u>Rs 150-00</u> (Sd.) <i>B</i> </p>

The above draft, when accepted by *A* would bear across the face of it the following writing—

ACCEPTED
 (Sd.) *A*
 Bombay, 20th July 1979

The holder of this bill i.e. *B* can now hold it to till its due date, viz. 23rd August (which includes three days of grace) and recover Rs 150 on that date from *A* the acceptor. If *B* likes he may indorse it over to any one in payment of any debt owing, or if he happens to be in want of money before maturity of this bill, he may discount it with his banker, as in the case of the promissory note dealt with above. It will thus be noticed that in this case, though *A* obtains goods on a month's credit, *B* obtains an instrument which renders almost the identical service that ready cash would have rendered, because he can either hold it on, or discount it and obtain cash, or use it in payment of his own debt to others.

In the case of *foreign bills* i.e. bills drawn on firms and individuals outside the country, they are generally drawn in sets of three, each part being numbered and called a 'via' and as soon as any of them is paid, the others become inoperative. If, however, a person accepts or indorses different parts of a bill in favour of different persons he and the subsequent indorsers of each part are liable on such part as if it were a separate bill (S. 132). As between holders in due course of different parts of the same set he who first acquired title to his part is entitled to the other parts and the money repre-

sented by the bill (S. 133). Whether a bill is inland or foreign is a question of fact. Even if a bill is drawn in a foreign language in England or India it will be an inland bill notwithstanding, if it answers the definition of an inland bill.² It must also be remembered that in the case of *foreign instruments* (except where there is a contract to the contrary) *the liability of the maker, or drawer of a foreign promissory note, bill or cheque is regulated by the law of the place where he made the instrument, and the liability of the acceptor and the indorser by the law of the place where the instrument is made payable* (S. 134).

ILLUSTRATION

A bill of exchange was drawn by *A* in California, where the rate of interest is 25 per cent, and accepted by *B*, payable in Washington, where the rate of interest is 6 per cent. The bill is indorsed in India and is dishonoured. An action on the bill is brought against *B* in India. He is liable to pay interest at the rate of 6 per cent only; but if *A* is charged as drawer. *A* is liable to pay interest at the rate of 25 per cent (Illus. to S. 14)

In case of dishonour of such an instrument, the *law of the place of payment governs dishonour* (S.135).

ILLUSTRATION

A bill of exchange drawn and indorsed in India, but accepted payable in France is dishonoured. The endorsee causes it to be protested for such dishonour, and gives notice thereof in accordance with the law of France, though not in accordance with the rules herein contained in respect of bills which are not foreign. The notice is sufficient (Illus. to S.135).

If a negotiable instrument is made, drawn, accepted or indorsed out of India, but in accordance with the law of India, the circumstance that any agreement evidenced by such instrument is invalid according to the law of the country where it was made does not invalidate any subsequent acceptance or indorsement made thereon

<i>London, 21st July, 1979</i>	
<div style="border: 1px solid black; width: 80px; height: 80px; margin: 0 auto; display: flex; align-items: center; justify-content: center;"> Stamp </div>	<p>Sixty days after sight of this First of Exchange (second and third of the same tenor and date unpaid, pay to the order of Messrs. Lyon, Sons & Co., Bombay, the sum of Rupees Two Hundred only.</p> <p>Value received.</p> <p style="text-align: center;"><u>Rs 200-00</u></p> <p style="text-align: right;">(Sd.) Lyon, Sons & Co.</p> <p>To Messrs. Jamshedji & Framji, Bombay</p>

² *Marseilles E.R. v. Land Co.*, (1885) 30 Ch. (598)

in India (S.136). They are *drawn in a set* so that they can be sent by different mails, or through different routes, to ensure at least one reaching its destination.

The second would read as—

<i>London, 21st July 1979</i>	
Stamp	<p>Sixty days after sight of this Second of Exchange (first and third of the same tenor and date unpaid) pay to the order of Messrs. Lyon, Sons & Co., Bombay, the sum of Rupees Two Hundred only. Value received.</p> <p style="text-align: center;"><u>Rs 200-00</u> (Sd.) Lyon, Sons & Co.</p> <p>To</p> <p style="text-align: center;">Messrs. Jamshedji & Framji, Bombay.</p>

The third would read as—

<i>London, 21st July 1979</i>	
Stamp	<p>Sixty days after sight of this Third of Exchange (first and second of the same tenor and date unpaid) pay to the order of Messrs. Lyon, Sons & Co., Bombay, the sum of Rupees Two Hundred only. Value received.</p> <p style="text-align: center;"><u>Rs 200-00</u> (Sd.) Lyon, Sons & Co.</p> <p>To</p> <p style="text-align: center;">Messrs. Jamshedji & Framji, Bombay.</p>

An inland bill or instrument is defined as a promissory note, bill of exchange or cheque drawn or made in India and made payable in or drawn upon any person resident in India (S. 11), whereas *a foreign bill or instrument is defined* as any such instrument not so drawn, made or made payable (S. 12). *In English law*, “an inland bill is a bill which is or on the face of it purports to be (a) both drawn and payable within the British Islands, or (b) drawn within the British Islands upon some person resident therein. Any other bill is a foreign bill (S. 4 Bills of Exchange Act). The British Island would include the United Kingdom of Great Britain and Ireland; the islands of Man, Guernsey, Jersey, Alderney and Sark, and the Islands adjacent to any of them being part of the Dominion of Her Majesty.

Consideration

As a negotiable instrument is also a contract consideration is necessary to support it, but unlike in the case of other contracts, *negotiable instruments are presumed to stand on the basis of valuable consideration*. The rules as to consideration are the same as those laid down by the Indian Contract Act except where they are opposed to the provisions of the Negotiable Instruments Act.

In the case of every negotiable instrument the *presumption*, until the contrary is proved, exists that it was made or drawn for consideration, and that every such instrument, when it has been accepted, indorsed, negotiated or transferred, was accepted, indorsed, negotiated or transferred for consideration [S. 118(a)]. This presumption may be rebutted by showing that the instrument was obtained from its lawful owner by means of fraud or an offence or that no consideration was in fact given. As the consideration here is presumed the party denying it has to prove his case. This of course applies to instruments which are negotiable.

It is the usual practice to insert the words "*value received*" or a similar statement of consideration in bills of exchange and promissory notes though *in law they are not necessary*. It may be added that a person who holds a bill of exchange for collection with a lien on the bill is a holder of the bill for consideration.³

Accommodation Bill

An Accommodation Bill, also known as a "kite" or windmill", is one which is drawn, accepted or endorsed, although no value has been given for it, that is, one for which the drawer or acceptor has received no consideration. According to Section 43 of the Negotiable Instruments Act, "a negotiable instrument made drawn, accepted, indorsed or transferred without consideration, or for a consideration which fails, creates no obligation of payment between the parties to the transaction. But if any such party has transferred the instrument with or without indorsement to a holder for consideration, such holder, and every subsequent holder deriving title from him, may recover the amount due on such instrument from the transferor for consideration or any prior party thereto".

ILLUSTRATION

Where a bill is drawn by *A* and accepted by *B* without consideration, as between *A* and *B* the want of consideration will be a good defence. If, however *A*,

³ (*Royal Bank of Scotland v. Rahim Cassim & Son*, 27 Bom. L.R. 506)

the drawer, transfers the bill to C for valuable consideration and C presents it on due date to the acceptor B, the original absence of consideration as between A and B cannot be urged against C and B as a defence.⁴

The person for whose accommodation the instrument has been made, drawn, accepted or indorsed cannot, if he has paid the amount, recover it from any person who became a party to accommodate him. A party who has induced another party to make, accept, indorse or transfer the instrument to him for a consideration which he has failed to pay or perform in full, cannot recover on it an amount exceeding the value of the consideration (if any) which he has actually paid or performed.

Inchoate Instruments

When a person signs and delivers to another a stamped paper in accordance with the law relating to negotiable instruments in blank, or partially written, he is thereby taken to give *prima facie* authority to the holder to make or complete upon it a negotiable instrument for any amount specified therein, and *not exceeding the amount covered by the stamp*, and thus, the person so signing shall be liable upon the instrument in the capacity in which he has signed to a holder in due course. A person who was not a holder in due course cannot recover any amount in excess of that intended to be paid thereunder by the person signing and delivering (S. 20). *This section is based on the rule of estoppel.* Here the person by signing the document and delivering to others in blank or incomplete form, lays himself open to this risk through his own act. The necessary condition present here is that the document ought to be stamped according to rules applying to negotiable instruments and should have been given to a holder apparently with a view to be converted into a negotiable instrument. Not only the original holder, but even a subsequent holder may fill it up, but a mere agent for safe custody cannot. Besides, *the document must be filled in before it can be enforced.*

In the case of inchoate documents the most important principle is that the person to whom it was given in an incomplete form must fill it up and deliver it to the third party who seeks to sue the party signing. Thus where a blank acceptance was stolen from the acceptor and thereafter filled in as a bill and was negotiated to a holder in due course it was held that as he had not delivered it to anybody the thief had no authority to fill it in.⁵

⁴ (*Sakharam Mansram v. Gulabchand Tarachand*, 16 Bom. L.R. 743)

⁵ [*Baxendale v. Bennet*, (1878) 3 Q.B.D. 525]

ILLUSTRATION

In one case the name of the payee, *B*, was left blank by *A* and the instrument was delivered to *B* and subsequently payment of the amount due on the date was made to *B*. Thereafter *B* in collusion with his brother *C* (who knew that the instrument had been discharged) inserted *C*'s name in the blank space and completed the instrument. It was held that *A* was not liable as *B*'s authority as *A*'s agent to complete the instrument under Section 20 came to an end when the amount of the note was paid to him.⁶

Lost Bill

Where a bill of exchange is lost before it is overdue, the holder may apply to the drawer to give him another bill of the same tenor giving *security* to the drawer if required to indemnify him against all persons in case the lost bill should again be found, and in case the drawer refuses he may be compelled to do so [S. 45A]. *This rule only applies to bills and not to promissory notes* and the *right* to claim a new bill is *only against the drawer*, but the section is silent as to whether the acceptor and indorser can be compelled to accept it and indorse respectively.

Ambiguous Instruments

When an instrument is so made out that it can be construed either as a promissory note or a bill of exchange, *the holder may, at his election, treat it as either*, and the instrument shall be thenceforth treated accordingly (S. 17). This occurs when drawer and drawee are the same person or where the drawer is a fictitious person or does not have the capacity to accept the bill or to contract. *Once the holder makes his election, however, he is bound by it.*

Usances

In some European countries bills are *drawn at usances*, i.e. payable after a period fixed by custom for payment of a draft drawn in one country on another and made payable there. The usances have to be proved in each particular case by the person who pleads usance.

PARTIES TO A NEGOTIABLE INSTRUMENT

1. Drawer

The drawer is the person who draws the bill or cheque. He is known as *the maker* in the case of a *promissory note*. The drawer

⁶ [S. *Ahmad Ibrahim v. D. Ramadas*, 1953 Mad. W.N. 853.63 Mad. I, W. 1083; A.I.R. 1954 Mad 532]

must sign the bill because although there is no objection to the bill being accepted before the drawer places his signature on it, it remains incomplete and cannot be issued.⁷

2. Drawee

The drawee is the person on whom the bill or cheque is drawn and who is thereby directed to pay.

3. Acceptor

In the case of a bill of exchange, the drawee becomes the acceptor after he has signed his assent upon the bill, or if there are more parts than one, upon one of such parts and delivered it, or given notice of such signing to the holder or to some person on his behalf (S. 7).

4. Payee

The payee is defined as the person named in the instrument to whom or to whose order the money is by the instrument directed to be paid (S. 7). The drawer may make the bill or cheque payable to himself or may name another person to whom it has to be paid.

5. Holder

The *holder* of a promissory note, bill of exchange or cheque is defined as meaning any person entitled in his own name to the possession thereof and to receive or recover the amount due thereon from the parties thereto. Where the note, bill or cheque is lost or destroyed, its holder is the person so entitled at the time of such loss or destruction (S. 8). The holder of the bill may be the original payee named in the bill, or one to whom the bill is indorsed over by the original payee. In the case of a bill or promissory note payable to bearer, the bearer is the holder.

6. Holder In Due Course

A *holder in due course* means "any person who for consideration became the possessor of a promissory note, bill of exchange or cheque if payable to bearer; or the payee or indorsee thereof, if payable to order, before the amount mentioned in it became payable, and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title" (S. 9).

⁷ *M. Call v. Taylor*, (1865) 35 L.J. (C.P.) 365

It will be seen from the above definition that *the holder* should have become the possessor of the document *before the amount mentioned in it becomes payable* and thus if a person takes the document after it has already fallen due, he will not be called a holder in due course. Further, he should take the instrument *without having sufficient cause to believe that any defect existed*. In English law if it could be proved that the holder took the document *in good faith* it would be sufficient, *but in India* under this section more than mere *good faith is necessary* and therefore, it would not be sufficient to show that he acquired the document honestly but was a little negligent. It should also be remembered that *even a holder in due course cannot get good title if a previous endorsement was forged*.

With regard to a *bona fide* taking of the bill the fact that he paid full value for it will go a long way to prove it, whereas if much less than the actual amount of the bill is paid it will throw some doubt as to *bona fide* taking. In one case where a money-changer took a bank note for full value, giving actual cash for it, twelve months after he had received notice of a robbery, it was held that the circumstances of his forgetting or omitting to look for the notice was no evidence of *mala fide*.⁸ It may also be added that a promissory note, bill of exchange or cheque made, drawn or accepted payable at a specified place and not elsewhere must, in order to charge any party thereto, be presented for payment at the place (S. 68).

A person cannot be said to be a holder in due course if it can be proved that to his knowledge there was a defect in the instrument which came into his possession and this is a matter which can only be proved by evidence.⁹ A post-dated cheque drawn by a partner in his own favour was endorsed for consideration to a third party who knowingly accepted it. Here the third party must be diligent in the matter of making some further and independent inquiries about his cheque. If he neglects to do this, he cannot claim to be a holder in due course. The rule in Section 9 of the Negotiable Instruments Act which defines "holder in due course" is stricter than the rule of English Law as in India the payee or endorsee would be a holder in due course only if he obtained it "without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title."¹⁰ A

⁸ (*Raphael v. The Bank of England* 17 C.B. 171).

⁹ (*Jwala Bank Ltd. v Habib Ahmed*, A.I.R. 1952, Punj. 286).

¹⁰ *Sunderdas Sobhraj v. Liberty Pictures*, (1956) 26 Com. Cas. 455; A.I.R. 1956 Bom. 618.

person to whom a post-dated cheque is endorsed for valuable consideration and before due date for payment is a holder in due course where he did not know of any arrangement between the drawer and the endorser that the cheque should be presented only after all the goods ordered for had been delivered to the drawer.¹¹ In *Tarachand Kevalram v. Sikri Brothers*,¹² it was pointed out that a person who obtains an inchoate instrument for consideration and inserts his name as the payee does not thereby become a holder in due course. Section 9 of the Negotiable Instruments Act seems to contemplate and imply that there must be a negotiation or a transfer to the holder in due course by someone who had the authority to so negotiate or transfer the negotiable instrument. Further, the transfer should be of a negotiable instrument which an inchoate instrument is not.

7. Indorser

When the payee indorses the instrument *i.e.*, when he writes his name on the instrument with the intention of transferring it, he is also known as the indorser.

8. Indorsee

The person to whom it is indorsed is the indorsee. Indorsements are of various kinds, as we shall see later (S. 7).

9. Drawee in Case of Need

When, in the bill or in any indorsement, the name of any person is given in addition to the drawee to be resorted to in case of need, such person is called a "drawee in case of need".

10. Acceptor for Honour

When a bill of exchange has been noted or protested for non-acceptance or for better security and any person accepts it *supra* protest for honour of the drawer or of any one of the indorsers, such person is called an "acceptor for honour".

Capacity of Parties

The capacity of a party to draw, accept, make or indorse a bill or note is *co-extensive with his capacity to enter into a contract*. However, the *peculiarity of the bill* is that the *incapability of any one party to the bill in no way diminishes the liability of the others*.

¹¹ (*S. Hajee Mohd. Haneef Sahib & Co. v. Abu Backer* 69 Mad. L.W. 184, (1956) 26 Com. Cas 182 (1956) I.M.L.J. 471).

¹² A.I.R. 1953, Bom. 290. 55 Bom. L.R. 231; I.L.R.; (1953) Bom. 717.

Thus *a minor* may draw, accept or indorse and negotiate such an instrument so as to bind all except himself (S. 26). Majority in India is determined by the law of domicile. Under the *Indian Majority Act of 1875*, every person domiciled in India attains his majority at the age of 18, but if before his attaining this age, a guardian of his person or property was appointed by a Court or the supervision of his property had been taken up by a Court of Wards, the period of majority would be extended to the age of 21.

The capacity of a *person of unsound mind*, or a lunatic, to incur liability on a bill of exchange is the same as his capacity to contract, as we have discussed in the chapter on Contracts.

An agent duly authorised may make out, accept or indorse a cheque, bill or note in the name of his principal and thus bind the latter. If the agent signs in his own name he will be personally liable except to those who induced him to sign upon the belief that the principal only would be held liable (S.28).

A legal representative of a deceased person who signs his name to a promissory note, bill of exchange or cheque is personally liable unless he expressly limits his liability to the extent of the assets received by him as such (S. 29).

The capacity of a joint stock company to draw, accept or indorse a bill of exchange, or make and indorse a promissory note or hundi depends on its constitution or the nature of the business on the same principle as its power to contract as well as to borrow and lend money is determined. Such an instrument will be deemed to be made, accepted, drawn or indorsed on behalf of a company if so done by any person acting under its authority express or implied (S. 7, Companies Act, 1956).

ACCEPTANCE

An acceptance is the *assent by the drawee to the order of the drawer* which assent is expressed by him *in writing on the bill with his signature* with or without the word "accepted". Delivery after acceptance is *necessary* to complete it.

A bill should be *presented* to the drawee *for acceptance* because until he accepts he is not personally bound to pay. In the case of (1) a bill payable after sight, or where (2) the instrument itself stipulates that it should be presented for acceptance, or where (3) it is payable elsewhere than the place of business or residence

of the drawee, it must be presented for acceptance. The Act requires the assent to be written on the bill therefore an acceptance on a copy or a separate paper will not do. We have seen that a bill must be delivered after acceptance and on the same principle *the bill must be delivered after* being endorsed to make the property pass.

Similarly delivery is necessary to complete the making of a promissory note or the endorsement of a promissory note or cheque (S. 46). It should be noted that the mere fact of possession of a bill by the drawee cannot constitute acceptance. To fix the drawee with liability, acceptance by him of the instrument and not merely an acknowledgement of liability is necessary. However, as no particular form of acceptance is required an acknowledgment may be construed as an acceptance but it must satisfy the requirements of Section 7 and must appear on the bill and be signed by the drawee.¹³ The delivery may be either actual or constructive. A constructive delivery arises where after acceptance the acceptor writes to the holder informing him of his having accepted the bill. *Hundis may be accepted orally by local custom.*

When the bill is presented to the drawee for acceptance the presentor must if the drawee so requires allow the drawee forty-eight hours (exclusive of public holidays) to consider whether he will accept it (S. 63). In the case of bills payable after sight, presentment for acceptance is necessary in order to fix the maturity of the bill (S. 61). The same rule applies to promissory notes payable after sight (S. 62). It should be noted that only the drawee or all or some of several drawees, or a person named in the bill as a drawee in case of need or an acceptor for honour can bind himself by an acceptance (S. 33). Where there are several drawees of a bill of exchange who are not partners, each of them can accept for himself but none of them can accept it for another without his authority (S. 34).

Acceptance by Agent

A bill may be accepted by the drawee's agent on the latter's behalf but *the agent so accepting must make that point clear, or else he may be personally liable.* A bill signed by directors or agents of a company must make it clear that they sign on behalf of the company as its agents. In determining whether the signature is that of

¹³ *Jagjivan Mavji Vithlani v. M/s Ranchhoddas Meghaji*, 1954, S.C.J. 626 1954 S.C.A. 842; A.I.R., 1954 S.C. 554 (S.C.)

the principal or the agent, the construction most favourable to validity has to be adopted.¹⁴

We shall now proceed to discuss the various peculiarities as to "acceptance". The "acceptance" may be *general* or *qualified*.

General Acceptance

A *general acceptance* is where the drawee signs his name on the bill with or without the word "accepted", thereby signifying his assent to the bill. The signature of the drawee, even though it was placed on the back of the bill was held to constitute an acceptance.¹⁵

The acceptance must not state that the drawee is to fulfil his obligation in any other consideration than a payment of money.¹⁶ As a general rule the bill must always be accepted generally, and if the acceptor adds any qualification to it, it becomes a conditional acceptance, as we shall see later, in which case the drawer may either agree to such an acceptance or treat the bill as dishonoured by non-acceptance.

Qualified Acceptance

An acceptance may be *qualified* in various ways. It may be qualified *as to the amount* e.g., a bill may have been drawn for Rs 500, whereas the acceptor, perhaps arguing that he owes only Rs 300, may accept for Rs 300, as "Accepted" for Rs 300 (three hundred) only.

It may be *qualified as to time* where it undertakes the payment at a time other than that at which under the order it would be legally due, e.g., where a bill is drawn payable one month after date, the drawee accepts it as "Accepted payable three months after date".

It may be qualified as to place as where no place of payment being specified, it undertakes to pay at a particular place only, or where a place of payment being specified, it undertakes to pay at some other place only e.g., "Accepted payable at the Lloyds Bank and there only". If, however, the acceptance is worded as "Accepted payable at the Bank of India Ltd.", it is not qualified, because here the holder is not bound to present the instrument at the

¹⁴ [Elliot v. Box Ironside (1925) 2 K.B. 301]

¹⁵ [Young v. Glover (1857), 33 Jur. (N.g.) 637]

¹⁶ Russell v. Phillips (1850), 14 Q.B. 891

bank and may present it for payment at the acceptor's place of business.

It may be accepted as *payable in instalments*, as "Accepted payable in monthly instalments of Rs 50".

It may be *conditional* declaring the payment to be dependent upon the happening of an event, e.g., "Accepted payable when in funds", or "Accepted payable when goods consigned are sold".

It may be *partial* as when a bill is drawn for Rs 3,000 and is accepted for Rs 1,000.

The drawer or holder of a bill is not bound to agree to an acceptance which is qualified. He can treat the bill as dishonoured, and move for remedies open to him on that ground. If, however, the holder of such a qualified acceptance acquiesces in the qualified acceptance, all previous parties whose consent is not obtained to such acceptance are discharged as against the holder and those claiming under him unless on notice given by the holder they assent to such acceptance (S. 86). This is because *the drawer and endorser are in the position of sureties for the acceptor* and the surety as we saw in the previous chapter, is released from his liability for any alteration in the terms without his assent. *The English Bill of Exchange Act* further lays down that if after notice the drawer or endorser does not express his dissent within a reasonable time, he shall be deemed to have assented. If the acceptor wishes to qualify his acceptance he should do so in the "clearest language" so that any person who sees it may not have the slightest doubt as to the nature of the acceptance.

Liability of Drawer

The drawer of a bill is not primarily *liable* unlike the maker of a promissory note. The drawer by drafting the bill undertakes that on due presentment to the drawee, it will be accepted and paid according to its tenor, but if the bill is dishonoured either by non-acceptance or non-payment he, the drawer, will compensate the holder *if notice of dishonour* is duly given to or received by him (S. 60). Thus it will be seen that the drawer's liability is secondary or conditional.

Liability of Drawee

The liability of the drawee arises only when he accepts the bill, the only *exception* being in the case of the drawee of a cheque

having sufficient funds of the drawer in his hands (S. 31) and even then the liability is only towards the drawer and not the payee.¹⁷

Liability of Acceptor or Maker

With regard to the liability of the *maker* of a pro-note or the *acceptor* of a bill, Section 32 provides as follows—

“In the absence of a contract to the contrary, the maker of a promissory note and the acceptor before maturity of a bill of exchange are bound to pay the amount thereof at maturity according to the apparent tenor of the note or acceptance respectively, and the acceptor of the bill of exchange at or after maturity is bound to pay the amount thereof to the holder on demand.

In default of such payment as aforesaid, such maker or acceptor is bound to compensate any party to the note or bill or any loss or damage sustained by him and caused by such default”.

This liability of the acceptor of a bill and the maker of a promissory note is absolute and unconditional. They are liable even though the instrument was not presented to them for payment on due date. The only case contemplated by the words “contract to the contrary” is that of an *accommodation acceptor* of a bill or maker of a note who is not bound to pay it if presented by a party to the accommodation, though he would of course be liable to a *bona fide* holder in due course.

It will be seen here that the maker of a promissory note is bound to pay *according to its tenor* mainly because he has signed it and bound himself thereby. In the case of a bill of exchange, however, the drawee is not bound on it either to the payee mentioned in it or to a holder unless and until he accepts it. If the drawee refuses to accept, the only remedy open to the payee or holder is to sue the drawer or the previous indorser.

Only the drawee of a bill of exchange or all or some of several drawees, or a person named therein as a drawee in case of need or an acceptor for honour can bind himself by an acceptance (S. 33). Where there are several drawees of a bill of exchange who are not partners, each of them can accept it for himself, but none of them can accept it for another without his authority (S. 34).

The *acceptor* is defined by Section 7 as

“After the drawee of a bill has signed his assent upon the bill or, if there are more parts thereof than one, upon one of such parts, and delivered the same or

¹⁷ [*Jagjivan Mavi v. Ranchhoddas Meghji*, A.I.R. 1954, S.C. 554; 1954 S.C.A. 842; (1954) 2 M.L.J. 202].

given notice of such signing to the holder or to some person on his behalf, he is called the "acceptor".

Acceptor's Liability for bill drawn in a fictitious name: An acceptor of a bill of exchange drawn in a fictitious name and payable to the drawer's order is not, by reason that such name is fictitious, relieved from liability to any holder in due course claiming under an indorsement by the same hand as the drawer's signature, and purporting to be made by the drawer (S. 42).

The above section is based on the following rule of the *English Common Law*—

"Where a bill is drawn in the name of a fictitious person payable to the order of the drawer the acceptor is considered as undertaking to pay to the order of the person who signed as the drawer, and therefore an indorsee may bring evidence to show that the signature of the supposed drawer, to the bill and to the first indorsement, are in the same handwriting".¹⁸

In such a case as the drawer is fictitious and the bill is drawn to his own order the drawer and the payee are one and the same person and fictitious. Therefore, before such a bill can be negotiated, the supposed drawer must indorse it in his own handwriting.

It should be noted that the acceptor is liable in such a case only to a holder in due course and not to a holder who knew or had reason to believe that the drawer or the payee was a fictitious person.

Bills Retired and Rebate

A bill is said to be retired when *it is paid before its due date*. Here if the acceptor of a bill left with a banker for collection offers payment to the banker less interest for the remaining period he should consult his customer before taking the payment. Frequently "*rebate*" is allowed on the bills retired with the consent of the holder which is *an allowance made to the acceptor for early payment*. The rebate is computed on the amount of the bill for the remaining period at an agreed rate. There is one other meaning of the word "*rebate*". In the case of bills discounted by a banker at the accounts closing period, the balance of discount, which is not earned during the year for bills not yet due, is carried over to the next year and is called in the accounts "*Rebate on bills discounted*".

¹⁸ *Copper v. Meyer* (1820), 10 B. & C. 468

INDORSEMENT

Definition

An endorsement is defined by Section 15 as—

“When the maker or holder of a negotiable instrument signs the same, otherwise than as such maker, for the purpose of negotiation on the back or face thereof or on a slip of paper annexed thereto, or so signs for the same purpose a stamped paper intended to be completed as a negotiable instrument, he is said to indorse the same, and is called the indorser.”

It will here be seen that the indorsements, though they are usually written on the back of a document, may be on the face or on a separate paper attached to the instrument. It is, of course, desirable that the indorsement be in ink though one in pencil is not bad and has been held as within the custom of merchants in England.¹⁹

If a bill is made payable to more than one payee, they must all indorse unless they are partners in a trading firm, when one of the indorsees can sign on behalf of all. When the payee's name is wrongly spelt the indorsement should be in the same spelling as the instrument, but the payee may add thereafter his correct signature.

Effect of an Indorsement

When a negotiable instrument is indorsed and delivered to the indorsee, the property therein together with the right of further negotiation, passes to the indorsee. It must be noted that the indorsement on a bill of exchange, promissory note or a cheque made payable “to order” must be made on the instrument itself and that a transfer by means of a sale deed alone is not a negotiation nor is the transferee a holder thereof within the meaning of Section 8 of the Negotiable Instruments Act and cannot claim the rights of a holder under Section 43 of the Act.²⁰ The difference between a transfer by endorsement and a transfer otherwise than by endorsement (e.g. by a transfer deed executed by the transferor) of a negotiable instrument is that in the latter case the assignee will get the same right as the assignor whereas an assignee by endorsement would have all the rights and advantages of a holder in due course of a negotiable instrument.²¹ But it is quite open to the indorser to restrict or exclude such right or merely to constitute the indorsee an agent to indorse the instrument for some other specified

¹⁹ *Geary v. Physic*, 5 B. & C. 324

²⁰ *Jang Bahadur Singh v. Chander Bali Singh* (1939) All, 419

²¹ *Seshachalam Naidu v. Venkatachalam Chetty*, A.I.R. 1954, Mad. 820

person (S. 50). Thus when the indorsements are placed as "Pay the contents to C only", or "Pay C for my use" or "Pay C or order for account of B", or "The within must be credited to C"; the indorsements exclude the right of further negotiations by C.

An indorsement is not bad simply because besides the statement transferring the instrument it adds a statement as to the payment of consideration; e.g. "Pay the contents to C, being part of the consideration in a certain deed of assignment executed by C to the indorser and others" [ill (g) S. 50]. Such an indorsement does not exclude the right of further negotiation by C. The endorsee of a promissory note was held entitled to the amount under the promissory note and not merely the amount which he might have been proved to have actually paid for the endorsement or assignment of the promissory note in his favour.²²

In case a person who is not a party to the bill indorses it, he is in the position of a surety or guarantor to all subsequent holders.

Liability of Indorser

With regard to the Indorser, his position is that, in the absence of a contract to the contrary, if a person indorses and delivers a negotiable instrument before maturity, without in such indorsement expressly excluding or making conditional his own liability by making it *sans recours*, as we shall see later, he is bound to make good to every subsequent holder, in case of dishonour of the drawee, acceptor or maker the loss of damage caused to such subsequent holder through such dishonour. This is, of course, subject to the condition that due notice of dishonour has been given to or received by such indorser. Every person who becomes an indorser *after* dishonour is liable as upon an instrument payable on demand (S. 35).

The indorser not only transfers the document and his right, title and interest in it to the indorsee—and in case of the *bona fide* holder even a better and complete title though his own title may be defective—but he also undertakes that in case the bill or note is not paid when duly presented for payment according to its tenor, he (the indorser) will himself pay. The *condition precedent* here is that it should be presented for payment on the date and in case of dishonour due notice should be given to him. Thus every prior party to

²² *Thambusami Reddiar v. Chidambaram Pillai*, (1954) 2 M.L.J. 322; A.I.R. 1954 Mad. 960

a negotiable instrument is liable thereon to a holder in due course until the instrument is duly satisfied (S. 36). The maker, the drawer until acceptance and the acceptor are principal debtors to a holder in due course, whereas the other parties are liable as *sureties* for either maker, drawer or acceptor (S. 37). Thus indorsers are in the position of sureties to all subsequent parties for the prior indorsers, and the drawer of a bill before acceptance, the acceptor and the maker, are principal debtors. As between the sureties, each prior party is in the absence of a contract to the contrary, liable as a principal debtor to each subsequent party (Ss. 37 & 38).

ILLUSTRATION

A draws a bill payable to his own order on *B*, who accepts it. *A* afterwards indorses the bill to *C*, *C* to *D*, and *D* to *E*. As between *E* and *B*, *B* is the principal debtor, and *A*, *C* and *D* are his sureties. As between *E* and *A*, *A* is the principal debtor, and *C* and *D* are his sureties. As between *E* and *C*, *C* is the principal debtor and *D* is his surety.

The holder, however, must see that he does *not impair any of the prior indorsers' rights* because if he does so the said indorser will be discharged from his liability.

ILLUSTRATION

A is a holder of a bill of exchange made payable to the order of *B* which contains the following indorsements in blank—

First indorsement	—	" <i>B</i> "
Second indorsement	...	"Peter Williams"
Third indorsement	...	"Wright & Co."
Fourth indorsement	...	"John Rozario."

This bill *A* puts in suit against John Rozario, and strikes out, without John Rozario's consent the indorsements by Peter Williams and Wright & Co. *A* is not entitled to recover anything from John Rozario (S.40).

This is because *every indorser undertakes to indemnify his subsequent indorser or holder under him provided his rights are left unimpaired so that he can step into the shoes of the party he indemnifies as far as his right of recovery from prior parties is concerned.*

Again, if a drawee accepts a bill on which there is a *forged indorsement* of which he *knows* or has reason to believe that it is forged, he cannot refuse to pay on that ground. It would, of course, be *otherwise* if the acceptor *did not know* that the indorsement was forged (S. 41).

An indorsement by a rubber impression or in any other form of the facsimile signature is valid at law, if placed by the person whose signature it purports to be or through his authority, **but** bankers refuse to accept such indorsement.

Indorsee is the person to whom the bill is indorsed *i.e.*, the person specified to receive the amount mentioned in the instruments (S. 16).

Different Classes of Indorsement

The indorsement may be—

(1) **Blank** *i.e.*, only a signature.

If the instrument is indorsed in blank it will be payable to the holder thereof even though originally payable to order (S. 16). A blank indorsement is effected by the holder writing his signature only on the document. This makes the instrument transferable by delivery and equivalent to “payable to bearer”.

An instrument which bears a blank *indorsement* may be afterwards indorsed in full by the holder and in that case the amount of it cannot be claimed from the indorser in full except by the person to whom it has been indorsed in full or by one who derives title through such person (S. 55). Here the position is that where an instrument indorsed in blank in the first instant is afterwards indorsed specially, the bill remains transferable by delivery in connection with all parties prior to the special indorsement, but with regard to the special indorsement the person to whose order it is indorsed should indorse it to give it further negotiation.

In India, according to Section 85 (2) a bearer cheque remains a bearer cheque notwithstanding any endorsement appearing thereon. This sub-section provides that “where a cheque is originally expressed to be payable to bearer, the drawee is discharged by payment in due course to the bearer thereof, notwithstanding any endorsement whether in full or in blank appearing thereon, and notwithstanding that any such endorsement purports to restrict or exclude further negotiation”.

(2) **Special or Full**, is made up by adding to the signature of the indorser a direction to pay the amount to, or to the order of, a specified person (S. 16) *e.g.*,

Pay to John Smith or order,
(Sd.) WILLIAM GREEN.

(3) **Partial**, *e.g.*, where only a part of the amount of the bill is transferred. This does not operate as a negotiation of the instrument; but where such amount has been partly paid, a note to that effect may be indorsed on the instrument which may then be negotiated for the balance (S. 56).

ILLUSTRATION

(a) If, therefore, a bill for Rs 100 is indorsed in favour of *A* for Rs 50 only, it is a partial indorsement and therefore invalid for negotiation, but if the whole amount is indorsed over to *A* and *B* jointly, the indorsement would of course be good for the purpose of negotiation.

(b) If a bill for Rs 100 is indorsed "Pay Rs 20 to *A* and Rs 80 to *B*", it would also be invalid for negotiation though here the full amount is transferred.

(c) In *Thambusami Reddiar v. Chidambaram Pillai*²³, the promissory note was for Rs 429-8-0 and the assignment was for only Rs 260. It was held that the endorsee was entitled to the full amount due under the promissory note (*i.e.*, 429-8-0) and not what the endorsee might have paid by way of consideration to the endorser.

(4) **Restrictive**, *i.e.*, (a) where it prohibits further negotiation, as "Pay to *M* only", or (b) restricts the indorsee to deal with the bill as directed by the indorser, as "Pay to *M* or order for collection" (S. 50).

(5) **Sans recours**, *i.e.*, where the indorser makes it clear that the indorsee or subsequent holders should not look to him for payment in case of dishonour.

ILLUSTRATION

If *A* indorses a bill *sans recours* "without recourse" to *B*, and if *B*, agrees to take it with such an indorsement, he takes it with the understanding that in case he (*B*) fails to recover money from the acceptor or any of the previous indorsers to *A*, he (*B*) cannot sue *A* on the bill. If an indorser who has excluded his own liability afterwards becomes the holder of the instrument, all intermediate holders are liable to him *e.g.*, *A* is the payee and holder of a negotiable instrument. Excluding personal liability by an indorsement "without recourse", he transfers the instrument to *B*, and *B* indorses it to *A*. *A* is not only reinstated in his former rights, but has the rights of an indorsee against *B* and *C* (S. 52).

(6) **Conditional**, *i.e.*, here some condition is attached to the indorsement. According to *English law* the person paying may ignore the condition, but *in India* if an acceptor accepts a bill after it was conditionally indorsed, he should respect the condition. There is no decided case on the point and the question, according to Chalmers, may be regarded as an open one.

(7) **Facultative**, *i.e.*, the indorsement waives some of the holder's duties towards the indorser, *e.g.*, "notice of dishonour waived". Here a subsequent party need not give him such a notice.

(8) **Sans frais**, *i.e.*, the endorser does not want any expense to be incurred on his account on the bill.

²³ (1954) 2 M.L.J. 322.

Indorsement by a Person Deceased

A negotiable instrument payable to order which has not been indorsed by the person deceased; or which has been indorsed by the deceased but who died before delivery, cannot be negotiated by delivery only, by his legal representative (S. 57).

ILLUSTRATION

If X, in whose favour a bill is drawn, indorses it and dies before delivering it, his executors or administrators cannot negotiate it on the indorsement of the deceased but should re-indorse it themselves in their legal capacity of executors or administrators.

Indorsement of a Lost Instrument or One Obtained by Fraud

When a negotiable instrument has been lost or has been obtained from any maker, acceptor, or holder, by means of an *offence* or *fraud*, or for an *unlawful consideration*, no possessor or indorsee who claims through the person who found it or obtained it by such unlawful means is entitled to receive the amount due thereon from the maker, acceptor, holder or any party prior to such holder, unless such a holder was the holder thereof in due course (S. 58).

Under this section would fall instruments obtained by theft, fraud, and unlawful consideration. In the case of *stolen instruments* the thief, of course, gets no title and cannot enforce it against parties to it, but if the instrument happens to be payable to bearer or indorsed in blank by a rightful holder, and the thief delivers it to an innocent holder in due course for value the said holder gets a good title and will be protected.²⁴ *The plea of fraud is good only against the party who is guilty of it or against his transferee who knew of the fraud when he took it. It will not affect the rights of a holder in due course.* The same rule applies to instruments obtained for an unlawful consideration.

Forged Indorsement

The above protection given by Section 58 does not extend to forged indorsements because of the rule "*forgery gives no title*". Forgery is a signature placed without authority and with a fraudulent intention. Such a signature is wholly inoperative on a bill as on any other instrument and, as we shall see, even a holder in due course of a negotiable instrument cannot derive any title under a forgery.

Where an instrument is indorsed in full, the signature of the person to whom or to whose order the instrument is negotiated is

²⁴ *Raphae v. Bank of England* (1825), 17 C.B. 161

necessary because *in the case of an indorsement in full, title can only pass through the indorsement*. If such an indorsement is forged even a holder in due course does not get a good title.²⁵

ILLUSTRATION

Where a draft drawn by a bank payable to *A* is endorsed by *B* as *A* in favour of a firm, no legal title passes to the firm as *B*'s act amounts to a forgery. The endorsement through which a holder in due course of a negotiable instrument claims must be genuine.

Thus in the case of a forged endorsement, it is not only that the holder in due course has a defective title but he has no title at all. In case such a holder obtains as the holder would be deemed to be holding the amount for the use of the true owner.²⁶

It is however different in the case of an instrument *endorsed in blank* because here no further indorsement is necessary as the title passes through mere delivery. Thus because the holder of an instrument indorsed in blank does not derive his title through a subsequently forged indorsement, he is entitled to ignore the forgery and sue any of the parties to the bill.

Transferee after Maturity or Dishonour

The holder of a negotiable instrument who has acquired it after dishonour, whether by non-acceptance or by non-payment, with notice thereof, or after maturity, has only as against the other parties, the right of his transferor (S. 59).

The acceptor of a bill of exchange, when he accepted it deposited with the drawer certain goods as a collateral security for the payment of the bill, with power to the drawer to sell the goods and apply the proceeds in discharge of the bill if it is not paid at maturity. The bill not having been paid at maturity, the drawer sold the goods and retained the proceeds, but indorsed the bill to *A*. *A*'s title is subject to the same objection as the drawer's title. (Illus to S. 59).

It will thus be seen that a *transferee who takes a bill after date of maturity*, even though he does so for a valuable consideration, is *not a holder in due course*. The same rule applies to one who takes it after it is dishonoured, provided he has notice of dishonour.

This does not mean that a negotiable instrument cannot be negotiated or transferred after maturity. Section 60 clearly lays down that it can be transferred or negotiated—except by the maker,

²⁵ *Mascarenhas v. Mercantile Bank of India* 34 B.L.R. 1; *Thorappa v. Umedmalji*, 25 Bom. L.R. 603

²⁶ *Pd. Ram Charan v. Kunwar Lal Thapper*, A.I.R. 1957 All. 104

drawee or acceptor after maturity—any number of times after the due date of payment. Its negotiability terminates on payment or discharge of this document at maturity or after it by the person ultimately liable to pay. If the instrument is paid before maturity it can still be negotiated by the person who paid for it, as the payment is not made in due course according to law in such a case.

If a bill is made *payable to more than one payee they must all indorse unless* they are partners in a trading firm, when one of the indorsees can sign on behalf of all. When the payee's name is wrongly spelt the indorsement should be in the same spelling as in the instrument, but the payee may add thereafter his correct signature.

Signature

It is necessary that the drawing, accepting and *indorsing* of a negotiable instrument should be made through the signatures of the drawer, acceptor and the indorser respectively. The *signature* may be in any *form* so long as it *indicate the intention and the identity* of the person who signs. If the signature is misspelt or not placed in the usual form that will not itself invalidate the instrumen.²⁷

The signature of the indorsement on a bill is the name of the party so placing his signature or that of the firm which he represents with proper authority. The law says that in case of a *partnership*, a bill or a note can be drawn, accepted, and indorsed, in the regular course of the business of partnership, by *any of the partners in the firm's name*, or if the partnership agreement specially provides, by the partner who has charge and management of the firm under this agreement. *The manager of a firm or company* may draw accept, and indorse bills of exchange in the regular course of the business of the firm, whereas a manager or assistant holding a power-of-attorney would sign as—

per pro Smith & Co.,
JOHN ROBINSON

A manager, agent or secretary of a company would sign as—

For the Lending and Borrowing Corporation, Ltd.,
L. RAJARAM
Manager

If, on the contrary, L. Rajaram signs as—

L. RAJARAM
Manager

The Lending and Borrowing Corporation, Ltd.,

²⁷ *Leonard v. Wilson*; (1834) 2 Cr. & M. 589

the signature will not be reckoned as one by the manager of the company on its behalf, but will be considered at law as the personal signature of L. Rajaram. It must also be borne in mind that in cases of *per pro* signatures it is clear that the person placing such a signature claims his authority to sign under a power-of-attorney. This *power-of-attorney* may be either very limited or very wide and general, and, therefore, before accepting this type of signature on any important document, or on a bill for a large amount, care should be taken to inspect the power with a view to ascertain whether the signature on such a document fall within the scope of the authority of the person signing. It must also be noted that if John Smith holds a power-of-attorney from the firm of Messrs. Ralli Bros., and if he happens to have granted a power-of-attorney to his friend Thomas Williams, Williams cannot sign for Ralli Bros., and therefore, a signature such as the following should not be accepted:—

Ralli Bros.,
per pro John Smith
THOMAS WILLIAMS.

On the same principle, directors of a company when they sign ought to sign as—

For The Lending and Borrowing Corporation, Ltd.

HIRJI NATHOO
HAROON KHALILI,
Directors

But if they sign as

HIRJI NATHOO
HAROON KHALILI,
Directors

The Lending and Borrowing Corporation, Ltd.

it will be considered at law as their signature and not on behalf of the company.

The *signature* on a bill or note *may be by a mark*, as we have seen above, *provided there is evidence to prove that the person signing by mark, habitually signs in that fashion.*

A *private individual* can sign through a duly authorized agent on the same footing as a corporation or a joint-stock company. Here the agent may either sign the name of the principal without adding his own name or stating that he acts for him, or the agents may sign his own name and then make it clear that he signs for the

principal named. An authority to draw a bill will not necessarily imply an authority to indorse. Again, general authority to transact business and to receive and discharge debts does not by itself confer a power to accept or indorse bills of exchange (S. 27). If however, the agent signs his own name only and does not indicate that he signs for his principal he will be personally liable on the instrument to all except those who induced him to sign upon the belief that the principal only will be liable (S. 28). If a person purports to sign for another without authority, the signature will be as inoperative as a forgery.²⁸ But where an agent signs in excess of authority a holder in due course will be protected.

PRESENTMENT

Presentment for Acceptance

A bill of exchange *payable after sight* must be presented to the drawee thereof for acceptance, if he can, after reasonable search, be found, by a person entitled to demand acceptance within a reasonable time after it is drawn, and during business hours on a business day. In default of such presentment, no party thereto is liable thereon to the person making such default.

If the drawee cannot, after reasonable search, be found the bill is dishonoured.

If the bill is directed to the drawee at a particular place, it must be presented at that place. If no particular place is mentioned it must be presented at his usual place of business, if any, or at his residence. If at the due date for presentment he cannot, after reasonable search, be found there, the bill is dishonoured. When authorized by agreement or usage, a presentment through the post office by means of a registered letter is sufficient (S. 61).

If the drawee has died presentment for acceptance or payment may be made to his legal representative and where he is insolvent to his assignee (S. 75).

The necessity of presentment for acceptance lies in the fact that here the holder is in a stronger position. Before acceptance he was in a position to enforce payment from the drawer and the prior indorsers in case the drawee failed to pay, but he cannot enforce payment from the drawee who has not accepted because in law *no person who has not signed the bill himself or through a duly empowered*

²⁸ *Bank of Bengal v. Macleod*, 5 I.A. 1.

agent can be made liable on it. The holder thus is under *no legal obligation* either to the drawee or drawer or indorser or *present* the bill *for acceptance*, as he is to present it on due date for payment, *except* in the case of a bill *payable after sight* or when he *has specifically agreed* to do so. To put it briefly, the *presentment for acceptance* though not obligatory, is *desirable*, being in the interest of the holder.

Presentment for acceptance is excused and the bill treated as dishonoured in the two obligatory cases mentioned above, in any of the following circumstances:—

(1) Where the drawee cannot after reasonable search be found (S. 61).

(2) Where the drawee becomes insolvent, when it may be made to his assignee (S. 75).

(3) Where the drawee is dead, when it may be made to his legal representative (S. 75).

(4) Where the drawee is a fictitious person (S. 91).

(5) Where the drawee is incapable of contracting (S. 91).

(6) Where though the presentment is irregular, acceptance is refused on some other ground [S. 41(2) Bills of Exchange Act].

A promissory note, payable at a certain period after sight must be presented to the maker thereof *for sight* if he can, after reasonable search, be found by a person entitled to demand payment, within a *reasonable time* after it is made and during *business hours* on a business day. In default of such presentment, no party thereto is liable thereon to the person making such default (S. 62).

The holder of a bill must, if so required by the drawee of a bill of exchange presented to him for acceptance, allow the drawee forty-eight hours (exclusive of public holidays) to consider whether he will accept it (S. 63). This section is based on *the English Common Law rule*. If the holder of a bill of exchange allows the drawee *more than forty-eight hours* (exclusive of public holidays), all previous parties including the drawer not consenting to such allowance are discharged from liability to such holder.

Presentment for Payment

Promissory notes, bills of exchange, and cheques must be presented for payment to the maker, acceptor or drawee thereof respectively, by or on behalf of the holder as provided by the Act. In default of such presentment the other parties are not liable to such holder (S. 64). Here of course the acceptor still remains

liable unless otherwise provided in the instrument itself as we have already seen. The same rule applies to *hundies* if they are not presented for payment on due dates, *i.e.*, the acceptor remains liable.²⁹ Where authorised by agreement or usage, a presentment through the post office by means of a registered letter is sufficient (S. 64).

The presentment must be made *during the usual hours of business*, and if at a banker's during banking hours (S. 65). In *English Law*, in the case of a non-trader the presentment is required to be made at any time before the hours of rest in the evening but this does not apply to *India*. Where the presentment is made at an unreasonable hour but payment is refused on some other ground, the bill is taken to be duly and properly presented.

A promissory note or a bill of exchange made *payable at a specified time must be presented for payment on maturity*. If the presentment is not made on the due date, all parties except the maker, acceptor or drawee are discharged (S. 66). A negotiable instrument payable on demand must be presented for payment within a reasonable time after receipt by the holder (S. 74). It was held in *Jhandu Lal Mithulal v. Wilayat Begum*³⁰ that no presentment for payment is valid unless it is made after the bill has reached maturity.

If a promissory note is made *payable by instalments* it must be presented for payment on the third day after the date fixed for payment of each instalment, failing which it will have the same effect as non-payment of a note at maturity (S. 67).

If the instrument is made *payable at a specified place* it must be presented for payment at the place in order to make the maker or drawer liable thereon (S. 69). Where it is not made payable at any specified place, it must be presented for payment at the place of business, if any, or at the usual residence of the maker, drawee or acceptor as the case may be (S. 70). If the acceptor or drawee or maker has no known place of business or fixed residence and no place is specified in the instrument, the presentment may be made to him wherever he can be found (S. 71).

With regard to presentment for payment *within a reasonable time*, a distinction has to be made between bills of exchange payable on demand and promissory notes payable on demand, as the latter

²⁹ *Benares Bank Ltd v. Hormusji Pestonji* (1930), 52 All, 696.

³⁰ (1925) 47 All: 572

are not intended for immediate payment and are treated as continuing securities, while bills are not so treated. In *Kalyanasundaram Ayyar v. Subramanya Ayyar*³¹ a period of 10 months was held not to be an unreasonable time within which presentment was to be made of a pronote between parties who were not merchants. In the same case it was also held that a delay of 6 or 7 days in issuing notice of dishonour is not an unreasonable delay in such a case although it would be fatal in the case of a bill of exchange or hundi.

To summarise, as to *presentment for payment*—

(1) When the bill or note is payable on demand the presentment must be made within a reasonable time.

(2) If payable after the expiry of some time it must be presented on the due date.

(3) It must be made at a reasonable hour and place.

(4) If made at a proper time and place and no person is found no further presentment need be made.

(5) If the acceptor, maker or drawee is dead it should be presented to his legal personal representative.

(6) If the acceptor, maker or drawee is insolvent, to his assignee.

(7) If there are two or more acceptors who are not partners it should be presented to all.

Presentment for payment is excused and the instrument may be treated as dishonoured in the following circumstances (as specified in Section 76)—

(1) When presentment is intentionally *prevented*.

(2) When the instrument is payable at the place of business of the acceptor, maker or drawee and he *closes* it during the usual business hours.

(3) When the instrument is payable at a specified place and no person authorised to pay it attends the place of payment during the usual business hours.

(4) When the instrument is not payable at a specified place and the person liable to pay *cannot be found* after due search.

(5) When presentment is *waived* either expressly or impliedly.

(6) As against the *drawer*, when he *could not suffer damage* through non-presentment, e. g. in the case of accommodation bills drawn for the accommodation of the drawer.

³¹ (1954) 1 M. L. J. 506, 1914 M.W.N. 174

With regard to (6) above, burden of proving, that the drawer could not suffer damage from the want of such presentment lies on the person suing. This burden is, however, very slight and is easily discharged in a case where the drawer and the drawee are one and the same person as in such a case the drawer must be deemed to know the due date of payment and that no payment had been made at maturity.³²

Presentment of a Bill at Bank

If a bill is made Payable at a specified bank where it has been duly presented for payment and dishonoured, if the banker so negligently or improperly keeps, deals with or delivers back, such bill as to cause loss to the holder he must compensate the holder for such loss (S. 77).

CHEQUES

Definition

A cheque is defined as: "A cheque is a Bill of Exchange drawn on a specific Banker and not expressed to be payable otherwise than on demand". Thus it will be noticed that if a bill payable on demand either to bearer or order is drawn on a specified Banker, it is a cheque both under the definition of Negotiable Instruments Act, Section 6, and the English Bills of Exchange Act, Section 73. It is stated to be *mandate* or command *on the Banker from his customer*, which mandate *must be obeyed strictly* according to its terms *so long as there is sufficient money to the credit of the customer*. Where the Banker by some negligence dishonours a cheque, which is regular in all other respects, in spite of there being sufficient credit to his customer's account, he is liable to be sued for damages by his customer on the ground that the customer's credit is thereby impeded. The damages will be substantial in case the customer is a businessman or merchant and the principle will be *smaller the cheque greater the damage*.

It may be noted however, that *bank's authority to pay the cheque is terminated*, if (1) the customer countermands payment, or (2) it hears of the customer's death, or (3) if a receiving order is made against the customer in the Bankruptcy Court of England, or an Adjudication Order of our Insolvency Court.

³² *Kanhayalal v. Ramkumar*, A. I. R. 1956 Raj 121 D. B

Difference Between Cheques and Bills of Exchange

The following are the main points of difference between a cheque and a Bill of Exchange.

(1) A cheque must always be payable on demand and drawn on a bank.

(2) Cheques are not entitled to any days of grace as Bill of Exchange are in case they are payable at the expiry of a period stated in the bill.

(3) Cheques are not required to be accepted, whereas bills of exchange require acceptance.

(4) It is not necessary that the holder should give notice of dishonour of the cheque to the drawer as is compulsory in case of bills of exchange.

Presentation of a Cheque

A cheque in order to charge any person except the drawer, must be presented to the banker upon whom it is drawn within a reasonable time after delivery thereof by such person (S. 73). In order to charge the drawer, a cheque must be presented at the bank before the relation between the drawer and his banker has been altered to the prejudice of the drawer. The drawer would be discharged if the drawer suffers actual damage through the delay to an extent equal to or greater than the amount of the cheque. What is a reasonable time would be determined having regard to the nature of the instrument, the usage of traders and bankers, and to the facts of the particular case [S. 84 (2)]. The holder of a cheque, however, as to which such drawer or person is discharged would have the right to stand as the creditor of the banker in lieu of the drawer to the extent of the amount of the cheque for which the drawer was discharged.

ILLUSTRATION

A draws a cheque for Rs 1,000 in favour of B on a bank, A has sufficient funds at the bank to meet it when the cheque ought to be presented. The holder does not present it within a reasonable time and the bank fails. The drawer is discharged but the holder can prove against the bank for the amount of the cheque. If, on the other hand, A had not sufficient funds to meet the cheque he would not be discharged but would have to pay the full amount of the cheque minus the damage suffered by him through the failure of the bank (Ss. 72 and 84).

It will thus be seen that as far as the drawer is concerned the holder must present the cheque within a reasonable time of the

drawer's issuing it. If therefore, the payee to whom the cheque is originally issued, or an indorsee to whom it is given in the regular course, keeps it for an unreasonable time and then gives it to some holder for value, such a holder, in case the cheque is dishonoured through the failure of the banker, can recover the amount from his immediately prior holder (in case, of course, he has presented it within a reasonable time of its receipt) but he cannot recover from the original drawer. What is a reasonable time depends, as we have seen, on *the usage of bankers*. A cheque is meant to be cashed immediately or within a reasonable time of its receipt and is not meant for circulation. An endorser is not liable on a cheque if it is not presented within a reasonable time after his endorsement. Of course, as far as the Common Law is concerned, a cheque is payable within the ordinary period laid down by the law of limitation, viz. three years in India and six years in Enland. But as a matter of practice or custom the banker does not pay a cheque presented to him after six months in India. In England some bankers decline to honour a cheque after six months, others after twelve months. This position rests entirely on the practice and course of business of bankers of a particular location, and this custom and practice is binding on all dealing with these banks. The holder, however, has his remedy against the drawer, who is bound to pay the cheque within the period of limitation. These cheques are called "Stale Cheques" which means cheques which have been circulating for an unreasonable length of time since the date of their issue. Any other negotiable instrument which is also payable on demand, should be presented for payment within a reasonable time.

Bearer Cheques

Under the Negotiable instruments (Amendment) Act of 1934 it is provided that *when a cheque is drawn as a bearer cheque it will always remain a bearer cheque notwithstanding any endorsement appearing thereon*. It should be noted that this provision in *the section does not apply to bills of exchange, other than cheques*. The law with regard to bearer cheques has been thus brought into line with that prevailing in England. Sub-Section 2 of Section 85 which is added by this Amending Act of 1934 reads as follow—

"Where a cheque is originally expressed to be payable to bearer, the drawee is discharged by payment in due course to the bearer thereof, notwithstanding any indorsement whether

in full or blank appearing thereon, and notwithstanding that any such endorsement purports to restrict or to exclude further negotiation”.

Where the *cheque*, however, is *payable to order*, it requires to be *indorsed* by or on behalf of the payee before the payment in due course of such a cheque can discharge the drawee banker [S. 85 (c)].

Crossed Cheques

A crossed cheque across the face of which two parallel lines are drawn with or without the words “and company” or any abbreviation thereof some other words the effect of which is that the banker on whom it is drawn shall not pay it otherwise than to a banker. A cheque may be crossed generally or specially. It should be noted that a crossing is operative only on a cheque and a postal order. If a bill of exchange other than a cheque is crossed the crossing is inoperative and the acceptor or party liable can pay to any person even though that person is not a banker.

When a cheque is *crossed generally* it bears two parallel lines without any words or with the words “and company” or its abbreviation (S. 123).

A cheque is, on the other hand, said to be *crossed specially* where it *bears across its face* an addition of *the name of a banker*, either with or without the words “not negotiable” (S. 124).

When a cheque as originally issued is uncrossed, it is permissible to the holder to cross it generally or specially. He can add the words “not negotiable” to the crossing. Where a cheque is crossed specially, the banker to whom it is so crossed may again cross it specially to another banker or his agent for collection (S. 25). In the case of a general crossing, it is the duty of the paying banker to see that the cheque is paid only to a banker and in the case of a special crossing, only to the banker to whom it is crossed, otherwise he will not be deemed to have made the payment in due course (S. 26). Where a banker makes such an irregular payment *i.e.*, pays a crossed cheque to a person other than a banker, or where it is crossed specially to a banker, pays it to some one other than the banker mentioned in the crossing, he will be responsible to the true owner for any loss he may sustain (S. 129). On the same principle, if the banker receives payment of a crossed cheque on behalf of a customer in good faith and without negligence in the regular course of business, he shall not incur any

liability to the true owner of the cheque in case the holder's title to the cheque proves defective (S. 131). If however, the crossing is obliterated, or is of a nature which cannot be noticed and the banker pays the same in good faith, he will also be protected. If a cheque is crossed specially to more than one banker, except when crossed to an agent for the purpose of collection, the banker on whom it is drawn must refuse payment (S. 127). If a cheque is crossed to two different branches of a bank, it would be considered as a crossing to a single bank, as the branches of a bank do not constitute two separate or distinct banks. It may also be noted that when a cheque is *crossed generally it may be altered to a special crossing but a special crossing cannot either be altered or be made a general crossing without the consent and the signature of the drawer.*

“Not Negotiable” Crossing

In the case of cheques crossed “generally” or “specially”, and bearing in either case the words “not negotiable”, their position, would be that such instruments shall not have, and shall not be capable of giving a better title to the holder than that which the person from whom they were taken had (S. 30). *The effect of a not negotiable crossing is to deprive the instrument of the special advantage which a negotiable instrument as such enjoys. The special advantage is, as we have seen, that the holder in due course of a negotiable instrument who receives it in good faith complete and regular on the face of it and without any notice as to any defect in title of a previous holder receives it free from all defences that may be had against a previous holder or the drawer, as to defect in title of the instrument. The “not negotiable” crossing of an instrument is often misunderstood; people believe that the holder of it cannot transfer it to any party and that such an instrument is payable to the holder alone which is far from being the case. An instrument crossed “not negotiable” may be indorsed any number of times as far as its transferability is concerned. Lord Halsbury, in *Laws of England*, says that “the effect of adding the words ‘not negotiable’ to a cheque is not to impede transfer, but to perpetuate in the hands of any transferee whatever defect or infirmity of title may affect the person who first transferred the cheque with those words on it”.*

Open Cheques

These are *uncrossed* cheques which may be presented to the banker on whom they are drawn and *paid over the counter*.

It is obviously risky to give an *open* cheque because if it is lost a finder can have it cashed over the counter at the bank or transfer it to a holder in due course. Even if the drawer has countermanded payment, a holder in due course of such a cheque is entitled to sue him. Similarly, unless the cheque is payable to order and the endorsement is forged, even the holder in due course of a stolen cheque acquires a good title.

Undated and Post-dated Cheques

If a cheque is not dated, the holder can, as in the case of any bill of exchange, insert the correct date if he knows it. Although the paying banker can insert the date, bankers generally return unpaid such undated cheques. Again, the drawer may draw post dated cheque, and such a cheque is not invalid. As they are in fact bills of exchange not payable on demand they should strictly speaking bear an *ad valorem* stamp duty. The cheques are issued on one date though a subsequent date is entered on them. This naturally amounts to, in effect, giving a bill payable at some future date. These cheques are frequently given and taken in connection with money transactions where instalments are agreed to be paid at certain specific future dates. Post-dated cheques are as much negotiable as cheques for which payment is due immediately on presentation.³³

A promissory note can also be post-dated. In such a case it cannot be sued upon until the ostensible date. The mere post dating of a promissory note does not mean there is no consideration as consideration can be paid at any time and may have been paid even at the time of original execution thereof.³⁴ Post dating of a bill of exchange is permitted by both English and American Law and the Indian Act does not prohibit it.

The Banker and Cheques of his Customer

The drawee of a cheque having sufficient funds of the drawer in his hands, properly applicable to the payment of such cheque, must pay the cheque when duly required so to do, and in default of such payment, must compensate the drawer for any loss or damage caused by such default (S. 31). *The banker here is in law bound to honour the cheque of his customer if regular and if there is sufficient balance to the customer's credit to enable him to pay out of it.* A cheque is not regular when it is not properly signed or indorsed, or where there is some

³³ *S. Hajeed Mohd Haneef Saheb & Co. v. V. S. Abbur Backer*, 69 Mad. L.W. 184; (1956) 26 Com. Cas 132; (1956) I. M. L. J. 471

³⁴ [*Fulchand v. Luxminarayan*, A. I. R. 1952, Nag. 308 (D. B.)]

material alteration which does not bear the customer's initials. The banker must also refuse payment when he hears of his customer's death, insolvency or lunacy, or where the customer countermands payment. The responsibility of the banker here is to his customer and his customer only and, therefore, the holder in case of dishonour must move against the drawer as he has no right against the banker. The customer, however, whose cheque has been wrongfully dishonoured, has a right to sue his banker for damages for loss of credit. The damages will be substantial, if the customer happens to be a trader.

The presentment of a negotiable instrument, either for acceptance or payment may be made to the duly authorised agent of the drawee or acceptor or maker; in case the drawee, acceptor or maker is dead, the presentment may be made to his legal representative, or, if he has been declared an insolvent, to his assignee (S. 75).

If the cheque was presented for payment, but for some reason the bank instead of paying the amount marked it, the conclusion would be the same.³⁵

Fictitious Payee

If the payee named in a cheque or a bill happens to be a *fictitious or non-existing person*, the bill is treated as a bill payable to the bearer according to Section 7 (3) of the English Bills of Exchange Act. Thus if a cheque is drawn as it used to be common in England at one time as payable to "*wages or order*", "*petty cash or order*", it was treated as payable to bearer, because here it is apparent that the payee is a fictitious or non-existing person. English bankers, however, discourage such cheques being drawn by their customers. In England it has been held that not only where a fictitious name is inserted, the bill is deemed to be payable to bearer, but that even the fraudulent insertion of the name of a real person may constitute a fictitious payee.³⁶ The *Negotiable Instruments Act* does not deal with this point and the question as far as India is concerned is not free from doubt.

MARKING OF CHEQUES

With regard to the marking of cheques the question may be discussed from *three standpoints*, viz. (1) marking at the instance of the customer, (2) marking as between bankers, (3) marking at the

³⁵ *In re Beaumont*, (1902) 1 Ch. at p. 895

³⁶ *Vagliano v. Bank of England* (1891), A.C. 107

instance of a holder. The certification or marking may be done in various forms e.g., by marking the cheque "approved" or "good", or by initiating the cheque.

Lord Halsbury, in Laws of England, states: "Occasionally cheques are marked or certified by the bankers on whom they are drawn. Doing so does not convert the banker into an acceptor or make him liable on the instrument, but it does constitute a representation by him on which he may be held liable, that the cheque will be paid as drawn if presented within a reasonable time. The effect on the cheque is to give it additional currency by showing on its face that it was drawn in good faith on funds sufficient to meet its payment and by adding to the credit of the drawer the credit of the banker on whom it is drawn.

1. Marking for Customers

The object with which marking is done is with a view to ascertain whether the customer has sufficient funds with the banker to be able to get the cheque honoured. If the cheque is marked at the instance of the drawer or the customer it is quite clear that the drawer will have no right of countermanding payment which of course, simplifies the question. Sir John Paget, in *The Law of Banking* says—

"The object and effect of a banker's marking cheques at the instance of the customer has been stated by the Privy Council to be to further the ready acceptance of the instrument by affording evidence on the face of it that it is drawn in good faith, and that there are funds sufficient and available to meet it, and as adding the credit of the drawee bank to that of the drawer."

The principal danger in the case of the marking of a cheque by the banker arises from the fact that after a cheque is marked the drawer of it may countermand payment, which he has every right to do in the second and third instances cited above, and the banker may be put in an awkward position as he has to indemnify the party for whom he marked should an innocent third party take the cheque relying on such a marking. If, however, the marking was done at the request of the customer the position is simplified because, as we saw above, the drawer cannot countermand without holding himself liable to indemnify the banker for any loss he suffers through his having marked the cheque, the payment of which is now stopped. British Bankers have such a prejudice against marking that even in the case of a request from a customer to mark his cheque they induce him to take their own draft instead.

2. Marking between Bankers—Constructive Payments

The *marking between bankers* has been legally recognized in England as a custom of bankers by which a marking is construed as a promise or undertaking to pay. It is, however, doubtful as to whether a customer can countermand payment after a banker has marked a cheque for another banker. The authorities seem to be conflicting on this point though, of course, the right of the customer to countermand payment previous to such a marking is clearly acknowledged.

In one case²⁷ Justice Buckley called such a marking “constructive payment”. His Lordship said; “He (Vice-Chancellor Stewart) must have so decided either because the cheque was constructively paid, the bankers having substantially said they would pay so that the payment constructively related back to the date of payment, or because the bankers had in effect said. “The account is in credit and we will hold enough of the balance to satisfy the cheque subject to the signature being shown to be genuine”. If the view expressed, viz., that such a marking constitutes a constructive payment, is correct, then, of course, the customer’s right to countermand, after such an operation is complete, is lost. It will thus been seen that the position of a banker marking for a banker is considered to be quite distinct from that of a banker making for his customer, though, of course, how far the decision would be upheld in future is doubtful. With regard to constructive payment Sir John Paget says: “In this as in some other similar cases, the banker’s conception of payment would not coincide with the legal. A court would infallibly decline to recognize as payment an operation expressly designed to give currency to a cheque, and performed before its issue”.

These remarks of Sir John Paget are based upon the *original intention and meaning of marking* which is, as we have seen, to make sure that the cheque will be duly paid because the drawer has ample funds and thereby it becomes more acceptable and readily transferable from hand to hand.

3. Marking for a Holder

The third case, that of a *holder presenting a cheque to the banker and getting it marked*, is not quite uncommon in India though it is not much prevalent in England, but the practice still prevails largely in America. There has been no decision on this question but it is

²⁷ *In re Beamount v. B. Ewbanks* (1902), 1 Ch. 88.

thought by the best authorities that such a marking would constitute nothing more than an intimation that at the time of making the banker had a sufficient balance to the credit of the drawer and that there is no appropriation by the banker.

Marking a Post-dated Cheque

In *Punjab National Bank v. Bank of Baroda*³⁸ it was held that certification of a post-dated cheque before it is due is anomalous and invalid although certification at a date when it has become due may be valid and operative. It was further observed that in the case of such certification, as the representation relates to a further date, it amounts to a promise requiring consideration to support it. It is interesting to note that the American and Canadian theory is that certification is equivalent to payment.

MATURITY

In the case of a promissory note or a bill of exchange, when made payable "*at sight*" or "*on presentation*" it is equivalent to payable on demand. Where an instrument is made payable "*after sight*" it means, in the case of a promissory note, after presentment for sight, whereas in the case of a bill of exchange it would mean either or after it is accepted, or if not accepted, after it has been noted or protested for non-acceptance (S. 21). The *maturity* of a promissory note or bill of exchange is the date at which it falls due. In *calculating* the maturity of a promissory note or bill which is not payable on demand, at sight or on presentation, three days, known as *days of grace*, must be added to the date on which the note or bill is made payable (S. 22). This rule applies whether the amount of the bill is payable in full or instalments. In the latter case, the three days of grace should be added in calculating the due date of each instrument. Our Act makes the addition of these days of grace compulsory, though originally the addition of these days in England and other European countries was purely voluntary. *The custom is made compulsory now in both England and India* by legislation, though in the principal European countries as well as in America it has been abolished. Thus the question whether these days are to be added or not will be decided by *the law of the country where the instrument is payable*. Again the corresponding section of the English Act (S. 14) permits the drawer or maker to make the bill or note payable at a date to which the days of grace are not to be added by clearly expressing such

³⁸ (1944) 48 C.W.N. 810; (1944) 2 A.E.R. 83 (P.C.)

an intention in the body of the instrument, but our Indian Act does not give such a power.

How to Calculate Maturity

While calculating the date at which a bill or promissory note which is made payable at a stated number of months after date or after sight, or after a certain event falls due, the period stated shall be held to terminate on the day of the month which corresponds with the day on which the instrument is dated or sighted or accepted or noted or protested for non-acceptance or the event happens, or where it is bill made payable so many months after sight and has been accepted for honour, with the day on which it was so accepted. If the month in which the period should terminate has no corresponding day, the period shall be held to terminate on the last day of such month (S. 23). Where months are stated, *Calendar months are to be reckoned*. Thus if an instrument dated 29th January 1878 is payable one month after date, it falls due on the 3rd day after 28th February 1878 and an instrument dated 30th August 1878, made payable three months after date, is due on 3rd December 1878 (Illus. to S. 23).

Indian and English Calculations Distinguished

In the case of an *after-sight bill accepted for honour in India*, the period is to be calculated from the day on which it was so accepted, and not, as in *England*, from the date of noting for non-acceptance. If the date on which the instrument falls due is a *public holiday*, the instrument shall be deemed to be due on the next preceding business day (S. 25). Here our *Indian Act* makes no distinction between bank holidays and other holidays as is done by the *English Act* where it is laid down that when the last day of grace is a Sunday, Christmas Day, Good Friday or a day appointed by Royal Proclamation as a public fast or thanksgiving day the bill is payable on the preceding business day, but when the last day of grace is a bank holiday, or a Sunday and the second day of grace a bank holiday, the bill is payable on the succeeding business day (S. 14, Bills of Exchange Act). Here as we have already stated above, all holidays are placed on the same footing because in the explanation of Section 25, it is now laid down by the Indian Act that "public holiday" includes Sundays and any other day declared by the Central Government, by notification in the Official Gazette, to be a public holiday.

DISCHARGE

The maker, acceptor, or indorser of a negotiable instrument is discharged from liability thereon (1) by payment, (2) by cancellation, and (3) by release.

(1) Payment

When payment is made at *maturity*, if it is of the *exact amount due* on the bill, note, or cheque, and is made to the holder of the instrument, it will *discharge every party to the bill from* his liability to pay the amount.³⁹ Payment by a stranger, if made on behalf of the party liable, will also be a discharge as if authorized by the party. An instrument made *payable* to bearer may be paid in due course as per its apparent tenor. If, however, *it is payable to a specified person or to order* it should be paid to the legitimate holder.

Where a bill or cheque has been *materially altered* either in the body or in the crossing, or where a *crossing is obliterated* even then, in case the alteration or obliteration is not apparent and the instrument is paid *bona fide* such a payment shall discharge the party liable thereto. It should, however, be remembered that if a bill which is not a cheque is crossed, in spite of that crossing it may be paid to anyone who is not a banker, as the crossing only applies to a cheque, a postal order or a dividend warrant.

If a payment is made to a wrong person it may be recovered from that wrong person by the person who made such a payment. The acceptor has a right of set off for any amount due to him by the holder and tender of the balance is good payment. In *The Indian Specie Bank v. Nagindas*,⁴⁰ where a bill drawn in favour of the bank by *N* was accepted by *M* and the bank went into liquidation, it was held that the liquidator was not entitled to be paid in cash for the full amount, but that *M* can set off the amount due by the bank to him against the amount of his acceptance and tender the balance in cash. As soon as that was done, the drawer *N* was discharged. In this connection, the following rule laid down in Section 81 of the Act is important—

Any person liable to pay, and called upon by the holder thereof to pay, the amount due on a promissory note, bill of exchange, or cheque, is before payment entitled to have it shown, and is on payment entitled to have it delivered up to him, or if the instrument is lost or cannot be produced, to be indemnified against any further claim thereon against him.

Interest on Amount

The amount due on the bill must include the interest if any, at the specified rate expressly agreed upon, which is to be calculated on the amount of principal money from the date of the instrument until

³⁹ *Chaitram Chaudhary v. Mohanlal Sarjooprasad Gour*, A.I.R. 1957 Nag. 65 (D.B.).

⁴⁰ 18 Bom. L.R. 689.

tender or realization of such amount, or until such date after the institution of a suit to recover the amount as the Court directs (S. 79). Here, of course, if the agreed rate is in the opinion of the Court usurious or excessive, the Court has as we have already seen in a previous chapter, the power under the *Usurious Loans Act* to interfere and order a fair rate only to be paid. *This interest will be payable from the date of the instrument up to the date of its discharge.*

If, however, no rate of interest is specified in the instrument, interest on the amount due thereon is to be calculated at the rate of 6 per cent per annum, from the date at which the same ought to have been paid by the party charged, until tender or realization of the amount due thereon, or until such date after the institution of a suit to recover such amount as the Court directs. An indorser, however, who has to pay a dishonoured instrument is liable to pay interest only from the time he receives notice of the dishonour (S. 80).

The person paying the amount due on a negotiable instrument is entitled to have it delivered to him. If the instrument is lost or cannot be produced, he is entitled to be indemnified by the payee against any further claim on the said instrument against him. Of course, the payment ought to be made in the current legal tender of the realm. A tender by cheque is not a legal tender and will be accepted at the creditor's option. When the creditor accepts a cheque in payment, he is presumed to have taken it as a conditional payment.

The bill must be paid to the holder or his duly authorised agent and for this purpose it has been held that the fact that a person possesses the document as apparently payable to him is presumed to be the holder in the absence of other evidence. In the case, however, of a person who holds the instrument under a forged indorsement the acceptor should not pay otherwise he may have to pay once over again to the rightful owner. This rule does not apply to cheques, as under Section 85, "Where a cheque payable to order purports to be indorsed by or on behalf of the payee, the drawee is discharged by payment in due course."

If an instrument is paid before maturity it can be re-issued and thus it is not discharged in such a case. The payment again should be made in legal tender money, and in this regard the ordinary rules applicable to agreements, which we have already dealt with, will apply. If the holder, however, agrees the bill may be discharged by delivery of goods or cancellation of a debt or issue of a fresh bill, note or cheque. The payment should be made by or on behalf of the

acceptor or maker because if the payment is made by an indorser or drawer or a stranger, the bill is not discharged for obvious reasons unless it is an accommodation bill.

The person liable to pay has a right to call upon the production of the instrument, and on payment to get it delivered up to him; in case the instrument is lost or cannot be produced, to be indemnified against any further claim thereon against his (S. 81).

(2) Cancellation

If the holder of a negotiable instrument cancels the acceptor's or the indorser's name *with the intention to discharge* him and all parties claiming under such holder, such an acceptor or indorser is considered discharged with regard to his liability as far as all parties claiming under such holder are concerned (S. 82). Also where the holder destroys or impairs the indorser's remedy against a prior party, *without that indorser's consent, as we have already seen that indorser is discharged from liability to the holder to the same extent as if the instrument had been paid at maturity* (S. 40).

It is also open to the holder to dispense with or remit wholly or in part the performance of the promise made to him by either *tearing up or cancelling* the instrument if so done with that intention.

Of course the cancellation must have been made deliberately and not under any mistake. The best method of cancelling a negotiable instrument is to *cancel the signatures by drawing a line through them or by writing the word, "cancelled" across the instrument*. Cancellation of any one signature out of the lot will discharge the party whose signature is cancelled, as well as parties subsequent to it. Thus cancellation of the signature of the drawer will discharge all indorsers.

(3) Release

On the same principle, as in the case of cancellation, the holder of an instrument may release or discharge its maker, acceptor or indorser. Also where the holder accepts satisfaction in any form other than a payment in cash, such a *substitution of a new contract or an alteration of the old one*, will be an ample discharge or release as far as the old instrument is concerned.

We have also seen that *if the holder of the instrument allows it to remain with the drawee for more than 48 hours exclusive of public holidays without the consent of the previous parties they are released by such conduct of the holder* (S.83).

ALTERATION

It may also be noticed that any material alteration of a negotiable instrument renders it void as against any one who is a party thereto at the time of making such alteration and does not consent thereto, unless it was made in order to carry out the common intention of the original parties. Such an alteration, if made by the indorsee, discharges his indorser from all liability to him in respect of the consideration thereof (S.87).

It may, however, be added that the alteration in order to come under the rule must be a material alteration and the mere fact that the alteration was made with dishonest intention will not render the instrument void.

Material Alterations

An alteration is material when (1) it is of the *date*, made with a view to reduce or increase the period of its currency (2) it is of the *sum payable*, (3) *the period* for which it is drawn is altered, *e.g.*, where a bill to run for three months is made to run for six, (4) *a new party* is added, (5) the *rate of interest* is altered, or (6) the *place of payment* is altered.

Alteration by a stranger will have the same effect as if it were made by the party himself as it is the duty of the holder of a negotiable instrument to preserve and safeguard it against such frauds.

Immaterial Alteration

Alterations such as (1) conversion from order into bearer or bearer into order by the rightful party, (2) addition of the words "on demand" in instruments where no time of payment is mentioned, (3) subsequent addition of the signature of witness to a signature by a party, and (4) alteration to correct a mistake, are not material alterations and will not vitiate the instrument.

Permissible Alterations

Alterations such as (1) crossing of cheques, (2) conversion of blank into special indorsements, (3) filling in of blanks in the case of inchoate instruments, (4) qualified acceptance, are permitted by the Negotiable Instruments Act.

Accidental or Unapparent Alteration

Again, if an alteration has been made by accident that will not be a ground for avoiding the instrument. The parties seeking to en-

force would have to show the circumstances under which the accidental alteration came to be made. We have, of course, seen that an alteration such as making a bearer cheque into an order cheque, or converting an order cheque into a bearer cheque, by the proper party, is permissible. Besides, as we have already noted above, where a promissory note, bill of exchange or cheque has been materially altered, but such an alteration does not appear on the face of it, or where a cheque is presented for payment which does not at the time of presentation appear to be crossed, or to have had a crossing which has been obliterated and if such a document has been paid by a person or by a banker liable on it according to the apparent tenor thereof at the time of payment and otherwise in due course, such a person or banker shall be discharged from all liability on that instrument and such a payment shall not be questioned by reason of the instrument having been altered or the cheque crossed (S. 89).

In *English Law* such protection is given only to a banker who pays an altered crossed cheque, whereas in *India* it is extended to persons who pay bills and notes also. Of course, the alteration should be such as is not *apparent on the instrument*; it should have been made in due course and it must have been *made by the person liable upon it*.

An acceptor or indorser is bound by his acceptance or indorsement notwithstanding any previous alteration of the instrument (S. 88).

Again, if a bill of exchange after going through its regular course of negotiation happens to come back at or after maturity into the hands of the acceptor in his own right, all rights of action are extinguished thereon (S. 90).

DISHONOUR

A bill, as we have seen, is said to be dishonoured when the *drawee refuses to accept it when duly presented*, or when it has been accepted and the *acceptor fails to meet it on due date*. A bill must be presented for payment to the acceptor on the due date, at his business place and at a reasonable hour. If he has no place of business, it may be presented at his residence. The presentment must be made to the acceptor or his agent duly appointed. If a bill is dishonoured by non-acceptance the party can move for his remedy without waiting for the time of maturity in order to present it for payment.⁴¹

⁴¹ *Ram Rauji Jambhekar v. Prahladdas*, 20 Bom. 133

Where the drawee is incompetent to contract, or the acceptance is qualified, the bill may be treated as dishonoured (S. 91).

Notice of Dishonour

As soon as a bill is dishonoured, *the holder must give notice of dishonour to the drawer and all previous indorsers (S. 93).* The notice, though not required to be in writing at law, must be a written notice for safety. The notice must be given *within a reasonable time*, i.e. if both the giver and the receiver of the notice reside in the same place, it should be given so as to reach at least on the day after dishonour. If they live in different places, the notice must be posted not later than the day after dishonour. If the notice is duly directed and sent by post and miscarries such miscarriage does not render the notice invalid (Ss. 94 & 106).

Anyhow, the holder must give notice of dishonour within a *reasonable time*. Of course, if for some reason the notice could not be given or did not reach any of the parties, through no fault of the giver of the notice, he would be excused. Otherwise *failure to give notice within a reasonable time would release all indorsers previous to the party failing to give notice, as well as the drawer.*

The *notice* has to be given *with a view to warn the parties of their liabilities* and not with a view to demand payment. The notice has to be given even though the party is aware of the dishonour. The notice has to be given in the case of dishonour *of a hundi* also, and if any *local usage to the contrary* in connection with these hundis exists, such usage has to be *proved*. The notice has to be given at *the place of business* of the party concerned and in case the party has no such place, at the residence of such a party (S. 94).

The notice should be given either by the holder, his agent or any party liable on it. *A notice by a stranger will be inoperative.* If the notice of dishonour is not given to the drawer or an indorser they will be discharged from liability except in cases where the law dispenses with such a notice, as we shall see hereafter. The holder should give notice to all the parties he can so as to be on the safe side. He should, as we have seen, at least give notice to the party immediately prior to him or his agent within a reasonable time in order to bind him, and that party should give it to the party prior to him, and so on. If the holder and the party to whom this notice is to be given carry on business or live in different places, such notice is given within a reasonable time if it is despatched by the next post, or on the day next after the day of dishonour. If they live or carry on

business in the same place, the notice should be despatched in time to reach its destination on the day next after the day of dishonour (S. 106). The party receiving the notice must present it within a reasonable time to other parties, *i.e.* within the same time as he would have had to give notice if he had been the holder (Ss. 95 & 107). The notice may also be sent by a special messenger. The notice of course should be properly addressed. *The notice should state the fact of the bill having been dishonoured and in what way the party to whom it is given will be liable thereon.* If the notice is deposited with an agent for presentment, the agent is entitled to the same time to give notice to his principal as if he were the holder giving notice of dishonour, and the principal is entitled to a further like period to give notice (S. 96).

Where the instrument is payable at a foreign place, *the law of the place of payment* will determine what constitutes dishonour and what notice of dishonour is sufficient.

When the party to whom the notice of dishonour is despatched is dead, but *the party despatching the notice is ignorant of his death, the notice is sufficient* (S. 97).

Notice when Unnecessary

Under the following circumstances notice of dishonour is unnecessary—

- (a) When it is dispensed with by the party entitled thereto;
- (b) in order to charge the drawer when he has countermanded payment;
- (c) when the party charged could not suffer damage for want of notice;
- (d) when the party entitled to notice cannot after due search be found; or the party bound to give notice is for any other reason, unable without any fault of his own to give it;
- (e) to charge the drawers when the acceptor is also a drawer;
- (f) in the case of a promissory note which is not negotiable;
- (g) when the party entitled to notice, knowing the facts, promises unconditionally to pay the amount due on the instrument (S. 98).

The above section lays down the circumstances under which notice of dishonour is excused. The party who has not given notice and wants to be excused for it should prove that his case falls under any of the above named exceptions. The notice may be waived before

or after the date on which the notice ought to have been given. *The omission of notice may be also excused when it is due to death, illness, accident to the holder or any other unavoidable circumstance. Ignorance as to the address of the party to whom the notice is to be given is also an excuse, provided due diligence is shown in trying to trace his whereabouts.*

Compensation

The amount payable in case of dishonour of a bill or cheque by any party liable to the holder, includes the amount due upon the instrument with interest, plus the expenses properly incurred in noting and protesting it. When the person charged resides at a place different from that at which the instrument is payable, the holder is entitled to receive such sum at the current rate of exchange between the two places. If an indorser of a bill has paid the amount due on it, he is entitled to the amount so paid plus expenses with interest at the rate of 6 per cent per annum from the date of his paying to the date of his receiving back the amount; and where the indorser and the person charged reside at different places the indorser would be entitled to receive such a sum at the current rate of exchange between the two places. It is also open to the party entitled to compensation on dishonour of such a bill, note or cheque to draw a bill on the party liable to compensate him making it payable at sight or on demand for the amount due to him together with all expenses properly incurred by him. Such a bill must be accompanied by the instrument dishonoured and the protest thereof, if any. If such a bill is dishonoured the party dishonouring the same is liable to make compensation thereof in the same manner as in the case of the original bill (S. 117).

NOTING

Besides giving the notice of dishonour the holder may get the bill "noted". This is done through a notary who presents the bill, notes down in his register the facts of its dishonour and the reason, if any, given by the acceptor for so doing. Such noting must be made within a reasonable time after dishonour and must specify the date of dishonour, the reason, if any, assigned for such dishonour, or if the instrument has not been expressly dishonoured, the reason why the holder treats it as dishonoured, and the notary's charges.

The rules with regard to Noting and Notaries-Public are to be found in the Notaries Act (LIII of 1952).

Legal practitioners or other qualified persons may be appointed as notaries by the Central Government for the whole or any part of India and by any State Government for the whole or any part of the State. The Governments concerned maintain a register of the notaries so appointed and entitled to practise. The notary is issued a certificate of practice. Every notary is required to have and use a seal and an act can only be deemed a notarial act if it is done by a notary under his signature and official seal. A notary may do all or any of the following acts by virtue of his office, namely—

“(a) verify, authenticate, certify or attest, the execution of any instrument;

(b) present any promissory note, hundi or bill of exchange for acceptance or payment or demand better security;

FORM OF NOTING

(To be made upon the instrument or upon a paper attached thereto, or partly upon each).

Reference to page in Notarial Register.

Date of presentment and dishonour.

Reason, if any, assigned for dishonour (or if the instrument has not been expressly dishonoured, reason why holder treats it as dishonoured).

Date of note.

Notary's charges.

(Sd.) A.B.

Notary Public

(c) note or protest the dishonour by non-acceptance or non-payment of any promissory note, hundi or bill of exchange or protest for better security or prepare acts of honour under the Negotiable Instruments Act, 1881 (XXVI of 1881), or serve notice of such note or protest;

(d) note and draw up ship's protest, boat's protest or protest relating to demurrage and other commercial matters;

(e) administer oath to, or take affidavit from any person;

(f) prepare bottomry and respondentia bonds, charter parties and other mercantile documents;

(g) prepare, attest, or authenticate any instrument intended to take effect in any country or place outside India in such form and language as may conform to the law of the place where such deed is intended to operate;

(h) translate and verify the transaction of, any document from one language into another;

(i) any other act which may be prescribed”.

PROTEST

When a promissory note or bill of exchange has been dishonoured by non-acceptance or non-payment, the holder may within a reasonable time, cause such dishonour to be noted and certified by a notary public. Such certificate is called a protest (S.100).

Protest for Better Security

When the acceptor of a bill of exchange *has become insolvent*, or his credit has been Publicly impeached, *before the maturity of the bill*, the holder may within a reasonable time, cause a notary public to *demand better security* of the acceptor, and on *its being refused*, may, within a reasonable time, cause such facts to be *noted, and certified* as aforesaid. Such a certificate is *called a protest for better security* [S.100].

When a promissory note or bill of exchange is required by law to be protested, notice of such protest must be given instead of notice of dishonour, in the same manner and subject to the same conditions. The notice, however, may be given by the notary public who makes the protest [S.102].

Protest of Foreign Bills

When the bill is a foreign bill, it requires both to be *noted and protested*, when such protest is required by the law of the place where it is drawn [S.104].

The protest must contain—

[a] either the instrument itself, or a literal transcript of the instrument and of everything written or printed thereon;

[b] the name of the person for whom and against whom the instrument has been protested;

[c] a statement that payment or acceptance, or better security, as the case may be, has been demanded of such person by the notary

public; the terms of his answer, if any, or a statement that he gave no answer, or that he could not be found;

[d] when the note or bill has been dishonoured, the place and time of dishonour, and, when better security has been refused the place and time of refusal;

[e] the subscription of the notary public making the protest;

[f] in the event of an acceptance for honour or of a payment for honour, the name of the person by whom, or the person for whom, and the manner in which, such acceptance or payment was offered and effected.

A Notary Public may make the demand mentioned in clause (c) of this section either in person or by his clerk or, where authorized by agreement or usage, by registered letter (S.101).

In the case of inland bills noting alone is sufficient.

When a bill or note is required to be protested within a specified time or before some further proceeding is taken, it is sufficient that the bill has been noted for protest before the expiration of the specified time or the taking of the proceedings, and the formal protest may be extended any time thereafter as of the date of noting (S.104A).

All bills of exchange which are drawn payable at some other place than the place mentioned as the residence of the drawee, and which are dishonoured by non-acceptance, may, without further presentment to the drawee be protested for non-payment in the place specified for payment, unless paid before or at maturity (S.103).

Acceptance for Honour

“Acceptor for honour” is defined as—

When a bill of exchange has been noted or protested for non-acceptance or for better security and any person accepts it *supra* protest for honour of the drawer or of any one of the indorsers, such person is called ‘an acceptor for honour’ (S. 7).

After the acceptor for honour has accepted the bill the holder at the due date has to present the bill first to the drawee for payment and if it is also dishonoured by non-payment by the drawee and noted or protested, as the case may be, it should then be presented to the acceptor for honour for payment (S. 112).

Section 108, Negotiable Instruments Act, further amplifies this by stating that “Where a bill of exchange has been noted or protes-

ted for non-acceptance or for better security, *any person, not being a party already liable thereon*, may, with the consent of the holder, by writing on the bill, *accept same for the honour of any party thereto*" [S. 65(1), Eng. B.E. Act]. As to how this acceptance for honour must be made, Section 109 lays down that the party must, "by writing on the bill under his hand, declare that he accepts under protest the protested bill for the honour of the drawer or of a particular indorser whom he names, or generally for honour". *When the acceptor does not express for whose honour it is made, it shall be deemed to be made for the honour of the drawer* [S. 110, N.I. Act S. 65 (4) Eng. B.E. Act.].

"Case in Need"

When in the bill or in any indorsement thereon the name of any person is given in addition to the drawee to be resorted to in case of need such person is called a "drawee in case of need" (S. 7). This is usually done when it is felt that the drawee may not be able or willing to accept or discharge the bill and therefore the name of another person is given to whom the holder may refer for payment in case the drawee dishonours the bill. In such a case the bill is not considered dishonoured until it is presented to the case in need and is dishonoured by him (S. 115).

In the case of *foreign bills*, a "case in need" is generally stated on the bill. *This case in need is the agent of the drawer in the foreign country, where the bill is made payable*. When, therefore, the bill is dishonoured either by non-acceptance, qualified acceptance, or by non-payment, the holder refers it to the "case in need". The "case in need" either gets the proper acceptance, or failing that, gets the bill protested for non-acceptance and accepts it himself for the "honour of the drawer". This is known as an "*acceptance for honour supra protest*". The holder then holds it till the due date when he presents it again to the drawee for payment which must be done because in case of an acceptance for honour this is an implied condition precedent without fulfilment of which the acceptor for honour is not bound to pay the bill. If payment of the bill be also refused, he should first get it protested for non-payment and then present it to the "acceptor for honour" who pays for the honour of the drawer.

In connection with *payments for honour*, Section 113 provides that when a bill of exchange has been noted or protested for non-payment, any person may pay the same for the honour of any party liable to pay the same, provided that the person so paying or his

agent in that behalf has previously declared before a notary public the party for whose honour he pays, and that such declaration has been recorded by such notary public.

The payer for honour is entitled to all the rights, in respect of the bill of the holder at the time of such payment and may recover from the party for whose honour he pays all sums so paid, with interest and with all expenses properly incurred in making such payment (S. 114).

A drawee in case of need may accept and pay the bill of exchange without previous protest.

The *object* served by this acceptance and payment for honour by the "case in need" is to *save expense by way of interest and loss on exchange* which would necessarily follow, as these foreign bills are generally drawn and discounted in the country of their origin. In the absence of such an arrangement, on the drawee's refusal to accept or pay the bill, the banker's foreign agent or branch office would refer the bill back to the office through which it was sent to him for collection. This would mean waste of time during the whole of which the banker's interest keeps running, not to speak of the great inconvenience to the drawer and loss on exchange, whereas it may be that the refusal to honour was based on grounds which could easily have been settled by an agent on the spot. Where a drawee in case of need is named in a bill of exchange, or in any indorsement thereon, the bill is not dishonoured until it has been dishonoured by such drawee (S. 115).

In the case of *acceptance for honour*, the said acceptor binds himself to all parties subsequent to the party for whose honour he accepts to pay the amount of the bill, if the drawee does not, and such party and all prior parties are liable in their respective capacities to compensate the acceptor for honour for all loss or damage sustained by him in consequence of such acceptance. An acceptor for honour is not liable to the holder of the bill unless it is presented, or if the address, given by such acceptor on the bill is a place other than the place where the bill is made payable, forwarded for presentment not later than the day next after the day of its maturity (S. 111).

It may be noted, however, that *protest is only necessary in the case of foreign bills*, specially when they appear to be such, but if there is nothing on the face of the bills to indicate their foreign origin, they need not be protested. *The protest is not necessary in the case of a foreign promissory note.*

RULES OF EVIDENCE

Presumptions

The following presumptions shall be made in the case of negotiable instruments until the contrary is proved—

(1) that every negotiable instrument was drawn, accepted and indorsed, made or transferred for consideration;

(2) that the date it bears is the date on which it was made or drawn;

(3) that it was accepted within a reasonable time after its date and before its maturity;

(4) that every transfer was made before maturity;

(5) that the indorsements appearing upon it were made in the same order in which they appear;

(6) in the case of a lost instrument that it was duly stamped;

(7) that the holder of it was a holder in due course (S. 118).

In the case of negotiable instruments, contrary to the ordinary law of agreements, consideration is presumed and the party who denies it must prove his case. This applies to drawing, accepting as well as indorsing. The next presumption is the correct date. Also that both its acceptance and transfer were made before maturity, that the indorsements were placed in the order in which they appear on the bill and that in the case of lost instrument the presumption is that it was properly stamped. All these presumptions can be rebutted by evidence but the party challenging them must prove his case.

Estoppel

The maker of a promissory note or the drawer of a bill of exchange or cheque or an acceptor for honour is estopped from denying the *validity* of the instrument made or drawn to the holder in due course. A maker of a note or an acceptor of a bill payable to the order of a specified person, is similarly estopped from denying the *payee's capacity* at the date of the note or bill, to indorse the same. An indorser of a negotiable instrument is not permitted to deny either the signature or the capacity to contract of any prior party to a holder in due course (Ss. 120–22).

International Law

In the absence of a contract to the contrary.

(1) *the liability of the maker or drawer of a foreign promissory*

note, bill of exchange or cheque, is regulated in all essential matters by the law of the place where the instrument is made; and

(2) the liability of the acceptor and indorser by the law of the place where the instrument is made payable.

ILLUSTRATION

A bill of exchange was drawn by *A* in California, where the rate of exchange is 25 per cent, and accepted by *B*, payable in Washington, where the rate of interest is 6 per cent. The bill is indorsed in India, and dishonoured. An action on the bill is brought against *B* in India. He is liable to pay interest at the rate of 6 per cent only; but, if *A* is charged as drawer, *A* is liable to pay interest at the rate of 25 per cent (S. 134).

As to dishonour and notice of dishonour the law of the place where it is made payable is applicable (S. 135).

The law of any foreign country regarding promissory notes, bills of exchange or cheques is presumed to be the same as that of India, unless and until the contrary is proved.

HUNDIS

Hundis are instruments drawn in an oriental language and probably have their derivation from the Sanskrit root "hund" which means "to collect". The derivation shows the purpose for which these hundis were originally used, viz. for the collection debts. Even today bills of exchange are generally used for the same purpose. If, for example, *A* sells goods to *B* for Rs 500, *A* can draw a hundi or a bill of exchange on *B* for the amount, the period of the bill, if any, fixing the credit allowed by *A* to *B* for payment of the debt of Rs 500.

The Negotiable Instruments Act generally does not apply to instruments in any oriental language (*hundis*), but whereby any words in the instrument itself the usages regarding such instruments are excluded, or where the writing expressly indicates an intention that the legal relations of the parties thereto shall be governed by the Negotiable Instruments Act, the Act will apply. In the absence of either of these indications, *hundis in oriental languages* shall be governed by local usages either of a particular market or a particular place, applying to such documents. *Hundis* are principally divided into two classes. viz. (a) the *Shah Jog hundis*, and (b) the *Jokhmi hundis*.

Shah Jog Hundi

The Shah Jog Hundi is drawn by one merchant on some other merchant asking the latter (drawee) to pay the said *hundi* to a *shah*,

i.e. a respectable holder, after making proper enquiry and taking the usual precautions taken by merchants in that line of business. It usually states the name of the person on whose account the *hundi* is drawn, or who has (as is usually the case) deposited money with the drawer against the *hundi* in question. The documents are generally used for the purpose of remittances. The drawer never accepts the *hundi* but generally they are presented to the drawer at the time of payment by the holder. These are not instruments which come under the designation of those "payable to bearer", but are payable to a "respectable holder" or "shah", and the usage throws this duty on the drawee, *i.e.* the duty of ascertaining that the payee is a "shah". In case the *hundi* is indorsed as payable to a particular person named in the indorsement, the drawee must see that he pays to that person and no other. As long as the drawee pays the said *hundi bona fide* to a "shah", he is entitled to recover the amount from the drawer. If the "shah" makes a mistake in collecting the *hundi* for a wrong party, he has to make good the amount with interest at the rate of 6 per cent from the date of payment to the date of refund. It has also been decided that in the case of a *shah jog hundi*, the drawee paying to the Shah is not absolved from liability to the owner of the *hundi*, if the Shah has no title to the *hundi* owing to a forged endorsement.⁴²

Arising from this case when the drawee wanted to be indemnified by the Shah for money he had to pay to the holder and thus to recover back from the Shah the money paid to the Shah on the Shah Jog Hundi with a forged endorsement, it was held by the Appeal Court that the cause of action against a shah who received payment under these circumstances is to re-imburse the drawee for money had and received to the use of the drawee, based either on the money having been paid under a mistake of fact, or without consideration and does not arise upon any implied covenant for indemnity.⁴³

It has been held in an Allahabad case, that a Shah Jog Hundi is not a Bill of Exchange under the definition of the Negotiable Instruments Act.⁴⁴ It was also held in the same case that a Shah Jog Hundi is a Negotiable Instrument independently of the provisions of the Negotiable Instruments Act in spite of the fact that it does not fall under the definition of a Bill of Exchange under that Act.

Nam Jog Hundi—The Nam Jog Hundi is payable only to the person whose name 'nam' appears on the *hundi* as payable to him or to his order. It is transferable unless it is accompanied by a descrip-

⁴² *Madhavdas Jethabai v. Dindas Vardasa* (1934), Bom L., R. 929

⁴³ *Madhavdas Jethabhai v. Sitaram Ram Narayan*, (1934) Bom. L., R. 941

⁴⁴ *Mangal Sen Jaideo Prasad v. Ganeshi* (1936) A. I. R. All 396

tion of the payee in which case it is non-transferable. The drawer is liable to pay the hundi if it is dishonoured.

Jokhmi Hundi

In the words of Bayley, J⁴⁵, “A *Jokhmi Hundi* is in the nature of a policy of insurance, with this difference, that the money is paid before hand, to be recovered, if the ship is not lost”. It is in fact a mode of insuring goods shipped peculiar to the native Indian merchants. There are here three parties—the drawer or shipper of the goods, the *hundiwala*, i.e. the underwriter, and the *malwala*, the consignee. The consignor consigns the goods, say from a port in Cutch or elsewhere to his agent or vendor in Bombay. He then draws a *hundi* on the consignee or *malwala* for the value of the goods and sells it to the insurer for cash which is the value less the insurance premium charged. The *hundiwala* sends the *hundi* either to his branch office or agent in Bombay. The *hundi* is then presented after the goods arrive safe in Bombay to the consignee or *malwala* who pays and takes delivery of the goods or in case he does not wish to take up the goods he may hand over the goods to the *hundiwala* and leave him to fight the matter out with the consignor. The *hundiwala* by this peculiar custom has no right to sue the *malwala* or consignee in case of non-payment or non-acceptance. His remedy is to recover the amount from the consignor. In case the goods are lost totally the *hundi* cannot be presented and the loss has to be borne by the *hundiwala* or underwriter. In the case of partial loss or damage, the *hundiwala* is entitled to be paid in full. In the case of general average loss the *hundiwala* or underwriter receives payment for so much loss as may be computed towards the general average loss on these goods by the Average Adjusters (4 Bom. 344-45).

The form in which these *Jokhmi hundis* are generally drawn, as given in the above reference (4 Bom. 344), is the following:—

FORM OF JOKHMI HUNDI

“To WIT: here have been kept and retained from *Shah*
Rs.....in full so the *hundi* is.....
jokhmi on board the vessel.....*nakwa*.....
 owner.....After the fixed time 4 (four) days after the
 vessel shall have arrived safely from the sea-port town of.....
 at the sea-port town of.....do you pay to *Shah*.....”

⁴⁵ *Raisey Amerchand v. Jusraj Vizpal*, Bom. 25th July, 1871

Zikri Chits

As per Chalmer's Negotiable Instruments, hundis, according to the custom of Marwari merchants, "are accepted for honour by means of Zikri Chits, which are furnished by a party liable on the *hundi*, to the holder, and are addressed to some other person who is thereby directed to pay the *hundi* if the drawee does not; the latter accepts by writing on the chit". The *hundis*, according to the custom of shroffs, are not required to be noted or protested.

Dhanijog Hundi

This is a *hundi* which is payable only to a Shah, but it may be cashed by the dhani or holder.

Purja

A *purja* is a written request, addressed to the lender and signed by the borrower, to pay the amount mentioned in the instrument, and is stamped with a one-anna stamp. The rate of interest is as mentioned in the body of the *purja* and the period for which the loan is granted is never mentioned in it, but is either understood to be the period settled by the prevailing practice or entered in a separate slip pinned to the *purja*. The *purja* is not attested by witnesses but is merely an acknowledgment of a debt. The name of the person through whom the sum is received is mentioned. These documents are generally used in connection with short loans, not exceeding three months. Frequently *purja* is also given in a different form, that is in the form of an acknowledgment by the borrower, declaring that he has credited the amount borrowed in his own account books in favour of the creditor.

FORM OF PURJA

(Transliteration)

Bhai Sri Nathuram Tekal Chand Selikhe Bhuramal Gopinath ka Ram Banchiyo upranch Ru 500 Akhre Panch So tumhare paslya kjaara beyaj dar 6 as. hissab bhejachh so laileja Rupaiya jamardarne dadejo miti 30 karohcee 1986 sal miti Mshag.

Dastahat,
(Sd.) SAWANLAL NAHATA

(Translation)

Honoured brother Nathuram Tekal Chand be pleased to accept the greetings (Ram Ram) of Bhuramal Gopinath. Further Rs 500 in words rupees five hundred, is being taken from you the interest on which at the rate of 6 as. is sent herewith. Please accept it and pay the money to Jamadar, dated 30th day of Magh 1986 Sal.

(Sd.) SAWANLAL NAHATA

(Note—Bengal Provincial Banking Inquiry Committee's Report).

Hatchita

This is a sheet bound in the account book of a creditor and entered in the form of a ledger, bearing a one-anna stamp and the signature of the borrower.

Khatapeta

This is an account in the creditor's book, showing on the debit side all amounts advanced to the debtor and interest accrued, and on the credit side all payments as well as interest paid. No receipts are given for the repayment of interest. Khatapeta is itself considered sufficient, as it is of the account and money given. The debtor makes written requests from the creditor for all advances he wants, and has to go and see that all his repayments as well as payments of interest are duly entered to his credit, in the same khatapeta. This form is generally maintained by Marwari Bankers.

Darsani and Nadappu Vaddi Hundis

These are sight hundis payable at sight, but the second has this peculiarity, that it carries interest at the nadappu vaddi rate from the date of presentation.

Muddati Hundi

This is a hundi which is not payable on demand like the darsani hundi, but is payable according to usance or custom.

Hundis payable to order are called Firmanjog hundis.

Paith

When the original hundi called khekha is lost, a duplicate or second copy is given, known as Paith. If the second is lost, a third

is given which is known as Parpaith, and in the event of all three being lost, a fourth hundi called Maijar or Panchayati is given. The last is called Panchayati, because five leading bankers of the place of issue have to draw it.

Nakal

Generally, the advice of the hundi is given by the shroff or banker who draws the hundi to the party on whom the hundi is drawn, as a separate letter. This is called nakal.

SUMMARY

Law: The Law relating to negotiable instruments is governed by the Negotiable Instruments Act, 1881.

Scope of Act: The Negotiable Instruments Act is not exhaustive. It applies to the issue and negotiation of promissory notes, bills of exchange and cheques.

It does not affect—

- (1) any local custom relating to any instrument in an oriental language, e.g., a hundi;
- (2) the provisions of the Reserve Bank of India Act, 1871, so that no one except the Reserve Bank or the Government can draw, accept, make or issue any instrument which amounts to an unconditional promise to pay a certain sum of money to bearer on demand.

Essentials of a Promissory Note

1. It must be in writing.
2. It must contain an undertaking or promise to pay.
3. The undertaking or promise must be unconditional.
4. It must be signed by the maker.
5. The maker must be certain.
6. The sum payable must be certain.
7. The undertaking to pay must be for money only.
8. The payee must be certain.

Essentials of a Bill of Exchange

1. It must be in writing.
2. It must contain an order.
3. The order must be unconditional.
4. It must be signed by the drawer.
5. The order must be on a certain person, i.e., the drawee must be a certain person.

6. The sum payable must be certain.
7. The order must be to pay money and money only.

Essentials of a Cheque: As a cheque is a bill of exchange drawn on a banker, all the essentials of a bill of exchange apply to a cheque with the addition of the following—

1. It is always drawn on a banker, and
2. It is always payable on demand.

Distinctions

Promissory Note	Bill of Exchange
1. Two parties—the maker and the payee.	1. Three parties—the drawer, the drawee and the payee.
2. The maker promises to pay.	2. The maker (drawer) orders the drawee to pay.
3. Promise to pay.	3. Order to pay.
4. The liability of the maker is primary and absolute.	4. The liability of the drawer is secondary and conditional.
5. The maker stands in immediate relationship with the payee.	5. The drawer stands in immediate relationship with the acceptor and not the payee.
6. Cannot be drawn in sets.	6. Can be drawn in sets.
7. Cannot be made payable to bearer because of section 31 of the Reserve Bank of India Act.	7. Can be drawn payable to bearer but not payable to bearer on demand because of Section 31 of the Reserve Bank of India Act.
8. Since the maker is primarily liable, no notice of dishonour is required to be given to him.	8. Notice of dishonour must be given to the drawer.
9. No protest necessary.	9. Foreign bills must be protested for dishonour if so required by the law of their cheque.

Bill of Exchange	Cheque
1. The drawee may be anyone.	1. The drawee must be a banker.
2. Entitled to 3 days of grace if time bills.	2. Payable without any days of grace.
3. Acceptance necessary.	3. No acceptance.
4. May be payable on demand or on the expiry of a certain period after sight or after date.	4. Must be payable on demand.

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|--|--|
| 5. Cannot be crossed. | 5. May be crossed. |
| 6. Mandate cannot be revoked | 6. Mandate may be revoked by countermanding payment. |
| 7. Notice of death or insolvency does not affect the mandate to pay. | 7. Authority to pay comes to an end on drawer's death or insolvency. |
| 8. Drawer is discharged if bill is not duly presented for payment. | 8. Drawer is not discharged by non-presentment for payment unless he has suffered damage by the delay. |
| 9. Notice of dishonour is necessary. | 9. Notice of dishonour is not necessary. |

Liabilities of Parties

Drawer of Bill	Drawer of cheque	Maker of Promissory Note	Acceptor of Bill
1. Primary until acceptance. Secondary after acceptance, i.e. like a surety.	1. Primary.	1. Primary.	1. Primary.
2. Liability arises only if due notice of dishonour has been given to, or received by him.	2. Liable to compensate holder if drawee bank dishonours cheque. If dishonour for any reason except want of funds, drawer will be entitled to notice of dishonour. Drawer liable even if cheque not duly presented for payment, unless he has actually suffered damage as result of such default,	2. Liable to pay at maturity.	2. Liable to pay at maturity if acceptance before maturity. Liable to pay on demand if acceptance at or after maturity

Drawee of Bill	Drawee of Cheque (or Banker)	Endorser
<p>Liable only after acceptance.</p>	<p>Always a banker liable to pay on demand provided—</p> <p>(1) he has sufficient funds of drawer;</p> <p>(2) funds are applicable to payment of cheque; and</p> <p>(3) cheque is duly presented for payment.</p>	<p>Liable to all subsequent holders except when—</p> <p>(1) there is a contract to the contrary,</p> <p>(2) he has qualified his liability, or</p> <p>(3) due notice of dishonour has not been given to him.</p>

Holder

Holder in due Course

May have obtained the instrument

Must have obtained the instrument

- (a) for unlawful consideration;
- (b) by gift;
- (c) at or after maturity;

- (a) for lawful consideration
- (b) before maturity;
- (c) in good faith, *i.e.* without sufficient cause to believe that any defect existed in the title of the previous holder.

(d) not in good faith.

Negotiation

Assignment

1. Mere delivery of bearer instrument. Endorsement and delivery of order instrument.
2. Notice for transfer not necessary.
3. Consideration is presumed.
4. Can convey to the transferee a better title than the transferor's.

1. Written document duly signed by transferor.
2. Notice by the transferee to the transferor or transfer of debt (actionable claim) to the debtor necessary.
3. Consideration must be proved.
4. The transferee's title is subject to the defects of the transferor's title.

Types of Indorsement

1. Blank or general.
2. Full or special.
3. Partial
4. Restrictive.
5. *Sans recours.*
6. Conditional or qualified.
7. Facultative.
8. *Sans fraits.*

Presentment may be

- I. for Acceptance
- II. for Payment

I. Presentment for Acceptance

Necessary

1. Where the bill is payable after sight.
2. Where the bill expressly stipulates for such acceptance.

Not necessary

1. Bills payable on demand.
2. Bills payable within a certain number of days after date.
3. Bills payable on a certain day.

Excused

1. Where the drawee cannot, after reasonable search, be found.
2. Where the drawee becomes insolvent, when it may be made to his assignee.
3. Where the drawee is dead, when it may be made to his legal representative.
4. Where the drawee is a fictitious person.
5. Where the drawee is incapable of contracting.
6. Where though the presentment is irregular, acceptance is refused on some other ground.

II. Presentment For Payment

Necessary

Promissory notes, bills of exchange and cheques must be presented for payment to the maker, acceptor or drawee.

Excused

1. When the bill or note is payable on demand it must be presented within a reasonable time.
2. If payable after the expiry of some time it must be presented on the due date.
3. It must be made at a reasonable hour and place.
4. When the instrument is not payable at a specified place and the person liable to pay cannot be found after due search.
5. When presentment is waived either expressly or impliedly.
6. As against the drawer, when he could not suffer damage through non-presentment, e.g., in the case of accommodation bills drawn for the accommodation of the drawer.

Distinctions**Acceptor for Honour**

1. Name does not appear in bill
2. Must be protested before the holder can resort to acceptor for honour.

Acceptance for Honour

1. Must be by a stranger to the instrument.
2. May be for honour generally
3. Requires holder's consent.

Drawee in Case of Need

1. Name must appear in bill and bill must be presented for acceptance within a reasonable time of dishonour by the original drawee.
2. Holder may resort to case in need without protesting it.

Payment for Honour

1. May be by any person whether already liable on the bill or not.
2. Must be for the honour of a particular party to the bill.
3. Does not require holder's consent.

Discharge of Negotiable Instrument

1. By payment.
2. By merger.

Discharge of some of the Parties

1. By impairing indorser's remedy.
2. By Release.
3. By Non-Presentment.
4. By allowing more than 48 hours for acceptance.
5. By taking qualified acceptance.
6. By a material unauthorised alteration.

Authorised Alterations

1. When the blanks in an inchoate instrument are filled up.
2. When a blank endorsement is converted into a full one.
3. When qualifying words are added to an acceptance.

Dishonour

1. By Non-acceptance.
2. By Non-payment.

Distinctions**Noting**

1. Making a note by a Notary on the instrument or on a paper attached to it to record the fact of dishonour.
2. A preliminary to the protest.

Protest

1. The certificate by the Notary of the noting having been done at or about the time of dishonour.
2. No protest without previous noting.

Rules of Evidence

Presumptions

1. Consideration.
2. Date.
3. Time of acceptance.
4. Time of transfer.
5. Order of indorsements.
6. Stamp on Lost Instrument.
7. Holder being holder in due course.

Estoppels

The parties to a suit on a negotiable instrument are not permitted to deny the following:—

1. Validity of the instrument.
2. Drawer's authority.
3. Payee's capacity.
4. Prior endorser's capacity.

International Law

Rules of Interpretation

1. Until the contrary is proved the law of a foreign country is presumed to be the same as the law of India.
2. Capacity to contract is determined by the law of domicile of the party at the time of making the contract.
3. The formal validity of the instrument is to be determined by the law of the place where the contract was made.
4. Even if prior agreements in a negotiable instrument are invalid according to the law of a foreign country, any subsequent acceptance or endorsement in India may be valid and enforceable against the parties in India if it complies with the law.
5. The law of limitation will be that of the place where the suit is filed.
6. The rights and liabilities of the maker or drawer of a foreign negotiable instrument are governed by the law of the place where he made that instrument.
7. The liability of the acceptor and indorser of a foreign negotiable instrument are governed by the law of the place where the instrument is made payable.
8. Dishonour and notice of dishonour of a foreign negotiable instrument are governed by the law of the place where the instrument is made payable.

Hundis are instruments drawn in an oriental language. They are governed by local usages even if such usages are inconsistent with the provisions of the Negotiable Instruments Act. Where local usages are excluded or the instrument so indicates, the Negotiable Instruments Act will apply.

Main Types of Hundis

1. **Shah Jog Hundi:** Payable only to a respectable person, a "Shah", who is deemed to guarantee the genuineness of the hundi.
2. **Nam Jog Hundi:** Payable only to the party named or to his order. The drawer is liable to pay if it is returned dishonoured or is unpaid.
3. **Jokhmi Hundi:** Drawn by consignor on consignee for the price of goods shipped by him in a ship named in the hundi. If the ship is lost at sea the loss falls on the holder of the hundi as if he had been the insurer of the goods who had paid the money in advance.
4. **Jawabi Hundi:** The person who owes money writes a letter to the payee and delivers it to his bank. The bank sends the letter to its branch in the place of business of the payee to whom it is forwarded by the branch. The payee gives a receipt in the form of a reply, "jawab", to the letter which is forwarded through the bank to the writer of the first letter.
5. **Zikri Chit:** It is a letter of protection accompanying the hundi and is to be used only if the hundi is not accepted by the drawee. It is usually addressed to some resident of the place where it is payable.

TYPICAL QUESTIONS

1. (a) *A* draws a bill payable to his own order on *B*, who accepts. *A* then endorses the bill to *C*, *C* to *D*, and *D* to *E*. What is the relationship between *E* and each of *B*, *A*, *C* and *D*?
- (b) A bill dated 31st August of a particular year was made payable three months after date. When was the bill at maturity? (That year Christmas day was a Monday).
2. (a) Distinguish between a promissory note, a bill of exchange, a cheque and a bank draft.
- (b) Can the purchaser of a bank draft countermand payment of the draft?
- (c) A cheque on which the payee's signature, by way of endorsement, has been forged, comes into the hands of *B*, who endorses it and delivers it to *C*, who takes it in good faith and for consideration. Discuss *C*'s title to the cheque.
(C.A.I.I.B., May, 1972)
3. (a) What is the effect of the failure of the consideration for the making of a promissory note?
- (b) What is the effect of placing on the face of a cheque the words "Not Negotiable" between two transverse lines; and of placing the same words alone on the face of a cheque without any other additions?

- (c) What provisions in the Negotiable Instruments Act have been extended to drafts? Why was it necessary to expressly extend these provisions to drafts?
 - (d) A negotiable instrument dated 22nd September, 1969 is made payable three months after date. When is it at maturity?
4. (a) What is the protection given by the Negotiable Instruments Act—
- (i) to the drawee of a cheque, and
 - (ii) to a banker collecting a cheque; and under what conditions is each protection available?
- (b) What are the kinds of dishonour of an instrument? To whom should notice of dishonour be given? In What cases is such notice not necessary?
5. Distinguish between any two of the following—
- (a) Promissory Note and Bill of Exchange.
 - (b) Acceptor and Acceptor for Honour.
 - (c) Holder and Holder in due course.
6. Write short notes on any three of the following—
- (1) Negotiation.
 - (2) Payment in due course.
 - (3) Inchoate Instrument.
 - (4) Bills in Sets.
 - (5) Accommodation Bill
 - (6) Noting and Protest.
7. Write Short Notes on any three of the following—
- (1) Deviation.
 - (2) Inchmaree clause.
 - (3) Jettison.
 - (4) G. A. Contribution.
 - (5) Lay days and demurrage.
8. (a) Define a Negotiable Instrument.
- (b) What bills of exchange must be presented for acceptance?
- (c) How must a notice of dishonour be given?
9. Write short notes on any three of the following—
- (a) Endorsement Sans Recours.
 - (b) Acceptor for Honour.
 - (c) Cheque.
 - (d) Facultative Endorsement.
 - (e) Maturity of an Instrument.
10. Explain clearly any three of the following—
- (a) Inland instruments.
 - (b) Ambiguous Instruments.
 - (c) Inchoate Instruments.
 - (d) Endorsement in full.
 - (e) Drawee in case of need.

11. Define a holder in due course. State and explain some of the important privileges of a holder in due course under the Negotiable Instruments Act.
12. (a) What steps should be taken by the holder when a bill of exchange has been dishonoured by non-acceptance or non-payment?
(b) *A* endorses a cheque made payable to him and crossed generally preparatory to paying it into his bank. Before he can take it to the bank it is stolen by *B*, who endorses it to *C*. *C* takes it in good faith and value and endorses it to his son *D* as a gift. Can *D* enforce payment of the cheque?
13. (a) What is the effect of the addition across the face of a cheque of two parallel transverse lines?
(b) *A* by mistake draws a cheque payable to *B* who does not exist. The cheque is negotiated by *C* by forged endorsement to *D*, who takes it in good faith and for value. Can *D* enforce payment of the cheque? Would it make any difference to your answer if *B* were in existence and the cheque was made payable to *B* or order?
14. What is the significance of the expression 'negotiation of the instrument'? What is the difference between negotiability and assignability.
15. (a) In what cases is a Banker justified in dishonouring a cheque? What are the liabilities and protection available to a paying banker?
(b) Explain the terms 'holder' and 'holder in due course' and discuss their rights.
16. (a) Has a holder any remedy against the banker for wrongful dishonour of a cheque?
(b) *D* drew a bill on *G* payable three months after date 'to the order of *D* only' and crossed it 'not negotiable'. The bill was accepted by *G* and endorsed for value by *D* to *H*. Is *H* entitled to recover the amount of the bill from *G*? Give reasons.
17. (a) State the protection given by the Negotiable Instruments Act to a banker collecting an instrument.
(b) What is material alteration of a bill and what is its effect?
(c) What is the position of a banker who pays a post-dated cheque before the date on the cheque?
18. (a) Compare and contrast: (i) promissory note and a bill of exchange; (ii) a bill of exchange and a cheque.
(b) Why does Section 85 A of the Negotiable Instruments Act deal specifically with bank drafts and what are its provisions?
(c) What is the competence of a minor to endorse a negotiable instrument?
19. (a) Define a cheque. Distinguish the same from a bill of exchange.
(b) What is meant by Negotiation?

OR

- (a) What are the different kinds of indorsements on a negotiable instrument?
- (b) What are the rules governing the maturity of a negotiable instrument?

Chapter 18

INSURANCE: LIFE ASSURANCE

CONTRACT OF INSURANCE

A CONTRACT of insurance is a contract between the *insured* on the one side and the *underwriter or the insurance company* on the other, which the latter, in *consideration* of a payment called the premium paid by the former, undertakes to *indemnify* the insured against any loss arising from a *contingency* upto the sum agreed upon.

Insurance contracts are effected to provide against a number of contingencies. They can be broadly classified under (1) **Personal Insurance**, including life, accident and sickness insurance (2) **Property Insurance**, including fire, burglary and fidelity insurance, (3) **Liability Insurance**, including employees' liability and motor car insurance against third party risks and (4) **Marine Insurance**. In this book we will deal with the most important types of insurance which we come across in business *i.e.*, life, fire and marine insurance.

There are various other forms of insurance, useful to businessmen, such as accident insurance, cash-in-transit policy, loss of profits policy, third party risk insurance, etc.

The essence of a contract of insurance is that it is *a contract of indemnity i.e.*, it ought not to be entered into for a mere wager or speculation, but only with a view *to provide against the actual monetary* loss which the insured is likely to suffer through the happening of the contingency under contemplation. If, for example, a person insures his building against loss by fire for an amount higher than the actual value of the building, he cannot, in case of destruction of the building by fire, recover more than the actual value of the building. On the same principles, if a person insures property which does not belong to him or in which he has no pecuniary interest either as a creditor or in some other capacity, the insurance contract cannot be enforced for want of insurable interest. The other peculiarity of a contract of insurance is a contract, *uberrimae fides*, *i.e.*, *a contract of absolute faith*; and the duty is thrown by law upon the insured *to make a full and fair disclosure of every material fact* that is likely to affect the judgment of the underwriter or insurance company in deciding what premium to charge or whether to enter into the contract at all. Thus any wrong disclosure, or any statement made fraudulently, negligently, or even innocently through want of knowledge, may vitiate the contract.¹

Nationalisation of Insurance

Both life insurance and general insurance have now been nationalised.

Life insurance was nationalised in 1956 by an Act resulting in the formation of the Life Insurance Corporation of India to which all life business of insurance companies was transferred.

General insurance was nationalised by the passing of the General Insurance Business (Nationalisation) Act, 1972, under which all the shares of Indian Insurance Companies on the appointed day (January 1, 1973), vested first in the Central Government and thereafter in the General Insurance Corporation of India.

LIFE ASSURANCE

Life assurance is *defined* in Smith's *Mercantile Law* as a "contract by which the insurer, in consideration of a certain premium, either in a gross sum or by annual payment, undertakes to pay to the person for whose benefit the insurance is made, a sum of money or *annuity* on the death of the person whose life is insured".

¹ *Tondon Ass. v. Mansel* (1879), 11 Ch. D. 363

Park, B., says;

“The contract commonly called life Assurance when properly considered is a mere contract to pay a certain sum of money on the death of a person, in consideration of due payment of a certain annuity for his life, the amount of the annuity being calculated in the first instance according to the probable duration of his life, and when fixed, it is constant and invariable.”

Assurance and Insurance

In life assurance, the person taking out the policy is assured a certain benefit in return for a certain number of premiums. This is not strictly a contract of indemnity and is generally referred to as life “*assurance*” and not as life “*insurance*”. These two words “*insurance*” and “*assurance*” are however, even today loosely used although the modern tendency is to use the word “*assurance*” in connection with a contract which assures the payment of a certain sum on the happening of an event which is bound to happen, *e. g.* death, whereas the word “*insurance*” is used where compensation is guaranteed to be paid on the happening of an event which may or may not happen. Thus insurance relates to contracts of indemnity against a contingency.

The Insurance Act 1938 defines “*life insurance business*” as meaning—

“the business of affecting contracts of insurance upon human life including any contract whereby the payment of money is assured on death (except death by accident only) or the happening of any contingency dependent on human life, and any contract which is subject to payment of premiums for a term dependent on human life and shall be deemed to include—

(a) the granting of disability and double or triple indemnity accident benefits if so provided in the contract of insurance;

(b) the granting of annuities upon human life; and

(c) the granting of superannuation allowances and annuities payable out of any fund applicable solely to the relief and maintenance of persons engaged or who have been engaged in any particular profession, trade or employment or of the dependents of such persons [S. 2 (11)].

Life Insurance Corporation of India (L.I.C.)

The Government of India nationalised life assurance business in 1956 by the formation of the Life Insurance Corporation of India. This Corporation has now that sole monopoly of life assurance business in India. The administration is effected through the central office at Bombay with five zonal offices, each at Bombay, Calcutta, Delhi, Kanpur and Madras. The Act establishing the Corporation

came into force on July 1, 1956 and the Corporation began to function on September 1, 1956.

On the eve of nationalisation Mr. C. D. Deshmukh the then Finance Minister described it as "a further step in the direction of more effective mobilisation of the people's savings...a nation's savings are the prime mover of its economic development. With a second (Five-Year) plan in the offing, involving an accelerated rate of investment and development, the widening and deepening of all possible channels of public savings has become more than ever necessary. Of this process the nationalisation of insurance is a vital part". This step was expected to result in the expansion of life assurance in rural areas, or using Mr. Deshmukh's words, "into the lives of millions in the rural areas it will introduce a new sense of awareness of building for the future in the spirit of calm confidence which insurance alone can give. It is a measure conceived in a genuine spirit of service to the people".

The objects as stated by the government in nationalising life assurance business was (i) to spread insurance over increasing areas, particularly in the rural areas; (ii) to ensure complete security to the policy holder and (iii) to mobilise and utilise public savings for the constructive activities of the Five-Year Plans.

As against that it was felt by some that life assurance cannot be developed adequately through a machinery such as a Public Corporation. Besides such a monopoly would avoid the benefits accruing from healthy rivalry between competing units. Further, the Corporation could seriously affect the general economy of the country through its large control over the investment market which was a dangerous and very powerful instrument in the hands of one Corporation.

The Act provides that the Corporation shall have the exclusive privilege, of carrying on life assurance business in India (S. 30)

Insurable Interest

Insurable interest means some pecuniary interest in the subject matter of the insurance agreement. Without such interest the policy will be regarded as a gambling policy and, therefore, void. With regard to life assurance, it must also be noted that a person *may assure his own life* upto any extent as he is supposed to have an unlimited interest in his own life, *or he may assure the lives of those dependent upon him, or through whose death he is likely to suffer*

a pecuniary loss. Where *life assurance* is effected for the benefit of a person other than the one whose life is assured, the person for whose benefit the policy is taken out, should be mentioned in such a policy and the amount of assurance should not exceed the pecuniary interest of such a person in the life of the assured *at the time of effecting the policy*. Therefore, if during the continuance of the life which is assured the interest of the party for whose benefit the policy was effected lapses, he can still recover on the policy. In the case of *fire insurance* the insurable interest must exist, both of the time the policy is effected and at the time the property is destroyed or damaged by fire. In case of *marine insurance*, on the other hand there need not exist any insurable interest at the time when the policy is effected, but if the holder of the policy at the time of loss happens to have acquired an insurable interest he can recover on the policy.

Policies effected for the benefit of persons who have no insurable interest are known as "*wager policies*" or "*gambling policies*" and are therefore void even where the underwriter has used words such as "*without further proof of interest than the policy*" or "*policy proof of interest*" or "*interest or no interest*".

It has been further held that a wife has an insurable interest in her husband's life and vice versa a parent has no insurable interest in the life of his child qua child; nor has a child an insurable interest in the life of his parent qua parent. A creditor has an insurable interest in the life of a debtor to the extent of his claim, and on the same principle a surety can claim to have insurable interest in the life of his principal debtor, joint promissory have an insurable interest in each other's lives etc.

The Procedure & Other Consideration

A person desiring to take out a policy, has to fill in a *Proposal Form*, which generally requires information with regard to the health of the proposer, his family history, facts relating to the life and habits of the proposer as well as evidence of his date of birth. Whilst giving this information the proposer must be accurate as contracts of assurance or insurance are contracts *uberrimae fidei*, i.e. of utmost good faith and from the information so given the underwriter is able to decide whether to accept or reject the proposal and the amount of premium to be charged. The proposer is also required to undergo a medical examination. The premiums are generally payable annually, although they may be arranged to be paid monthly, quarterly, and even weekly. Of course where the

instalment system is permitted an extra charge is made for the additional expense incurred in collecting the premiums as well as the loss of interest on the premiums not paid at the beginning of the year.

The Insurance Act, 1938 (S. 45) now provides that no policy of life insurance shall be called in question by the insurer after two years from the date on which it was effected (or two years after the commencement of this Act, where the policy was effected before the commencement of the Act) on the ground that a statement made in the proposal for insurance or in any report of a medical officer, or referee or friend of the insured, or in any other document leading to the issue of the policy, was inaccurate or false unless the insurer shows that such statement was on a material matter or suppressed facts which it was material to disclose and that such statement was fraudulently made by the policyholder who knew at the time of making it that the statement was false or that it suppressed facts which it was material to disclose. Of course this does not prevent the insurer from calling for proof of age at any time if entitled to do so.

Assignability

The policy of life assurance is assignable as *a claim under a charge in action* and it can be assigned in any form as long as it clear. It is, however, necessary to give *written notice* to the assurance company of such an assignment, to make the assignee's title effective against the company, otherwise if the company makes any payment to the assignor, after the assignment without the knowledge of the assignee, the company would be protected. *The assignment of the policy* carries with it the right to all bonuses and profits.

The Insurance Act of 1938 provides in Section 38 that a transfer or assignment of a policy of life insurance, whether made with or without consideration may be either by an endorsement placed upon the policy itself or by a separate instrument. In both these cases the signature of the transferor or assignor or his duly authorised agent is necessary. The signature must be duly attested by at least one witness. As soon as this is done the transfer or assignment will be complete and effectual. However, where the transfer or assignment is in favour of a person other than the insurer (*i.e.* the insurance company) a notice in writing of such transfer or assignment must be given to the insurer and the priority of all claims will be regulated in accordance with the dates on which such notices were delivered to the insurer. As soon as such a notice is given the insurer must record

the transfer or assignment mentioning the date thereof and the name of the transferee or assignee. A written acknowledgement can also be obtained by the transferee or assignee from the insurer on payment of a fee not exceeding Re 1 and such acknowledgement will be conclusive against the insurer that he has duly received the notice to which such acknowledgement relates (S. 38).

Nomination

The Insurance Act (S. 39) also makes provision regarding *nomination* by the policyholder. The holder of policy of life insurance on his own life may nominate the person or persons to whom the money secured by the policy shall be paid in the event of his death. This may be done by him either at the time of effecting the policy or at any time before the policy matures for payment. Such a nomination may be incorporated in the text of the policy itself or may be made by an endorsement on the policy. Where the nomination is by endorsement, this must be communicated to the insurer and registered by him in his records. *A nomination may of course be cancelled or changed by an endorsement or further endorsement or a will, as the case may be, at any time before the maturity of the policy.* In such a case however, unless a *notice in writing* has been given to the insurer of such cancellation or change, the insurer will not be liable for any payment under the policy made *bona fide* by him to a nominee mentioned in the text of the policy or registered in his records. Where a transfer or assignment has been made as mentioned in the previous heading a nomination shall stand automatically cancelled. This, however, does not apply to an assignment in favour of the insurer made in consideration of a loan granted by the insurer on the security of the policy within its surrender value or its reassignment on re-payment of the loan. In such a case the right of the nominee will be affected only to the extent of the insurer's interest in the policy. Where a nomination has been made and the policy matures during the lifetime of the insurer or where all the nominees die before maturity, the amount of the policy will be payable to the policy holder or his heirs or legal representative or the holder of a succession certificate, as the case may be.

Proof of Death

In case of policies payable at death, the death of the insured has to be proved. *The usual proof is a death certificate and a declaration as to the identity of the person described in such certificate.* In case of death by accident or suicide, a copy of the finding of the jury is required. In a case of death in a foreign country, the death certifi-

cate and the declaration of the medical practitioner who attended with the attestation of the Indian Consul is required. *Death is presumed where it is shown that a person who went abroad, or disappeared, has not been heard of for seven years, nor has he communicated with those he would have communicated with if alive.* Where a person was on board a steamer which is proved to have met with a storm and was heard of no more, that fact may be construed to have brought about the death of the person on board. The claimant is required to produce proof such as a probate or letters of administration.

Premiums & Risk

The premiums, as we have noticed above, are *payments made by the assured in consideration of the risk covered by the policy.* These payments may be payable either quarterly or half-yearly, according to arrangement. They are payable within the days of grace, generally allowed by every life assurance policy, or the assured may be required to undergo a second medical examination. *On the payment of the first of these premiums the risk on the policy begins and it is covered generally by what is known as the "covering note", which is a provisional agreement to run during the period which has necessarily to elapse before a regular policy can be drawn out.* The rates of premium payable on lives under various denominations are generally laid down in the company's prospectus. In cases of what are known as "*hazardous occupations*" such as those in connection with the Army, Navy, Mining, etc. or residence in a less healthy climate, *extra premium* is payable. Extra premium may also be charged on the ground of what is known as "*climate risk*", *i.e.* where a person who lives in a climate which is considered more healthy changes his residence for what is considered a less healthy climate, extra premium has to be paid.

Reinsurance

If a policy is taken out on one individual on one risk for a large amount, *it is usual for life offices to reinsure a portion of that risk with some other insurance company, or companies in league with the former.* This is known as reinsurance. Thus here the insurance company divides the risk with another insurance company. (This is explained in greater detail in Chapter 21, "Marine Insurance".)

Policies

Policies of life assurance are, as we have seen above, *agreements entered into between the insurance company and the assured.* The

two principal types of life assurance policies are (1) the "whole life" and (2) the "endowment" policies. In the "whole life" policy, the premiums have to be paid either till the date of death or for a fixed number of years according to the terms of the policy and the sum assured would be payable on the death of the assured to his heirs. In case of the "endowment" assurance, the sum assured is payable either on the death of the assured or on completion of a certain number of years (*i.e.* on the assured attaining a certain age) whichever is earlier. There are variations of these two types of policies.

The most important uses of life assurance are making provision for dependents or for old age. These policies may be put to other uses also. It may be used as collateral security for a loan or a policy may be taken out to facilitate payment of death duties or estate duty. In case of a partnership, when a partner dies the partnership firm is dissolved and the remaining partners who desire to carry on the business will have to pay out the deceased partner's capital to his heirs. The partners may find it difficult to pay such a large amount at once and in order to provide for this contingency they may take out suitable life assurance. This is referred to as *partnership assurance*.

In connection with these policies it may be noted that they may be either (1) *with profit* or (2) *without profit*. In case of the "with profit" policy, the assured is given, in addition to the sum assured, a share in the profits which are declared by the underwriter at intervals and credited to the policyholder as bonuses. In case of the "without profit" or "non-profit" policy, the policyholder does not share in the profits. Of course, the premium for the "without profit" policy is lower than that of the "with profit" policy. Life assurance policies attract businessmen because of the exemption given in connection with *income tax* in respect of premiums paid up to one-sixth of the income of the person concerned.

The *premiums* on the policies may be spread over the whole life of the assured, in case of whole life policies, or they may be payable for a fixed term after which the payment of premiums ceases, but the policy runs on till death. This is known as *limited payments policy*.

There are also *ascending scale policies* under which premiums of smaller amounts are payable at the start and are gradually raised at agreed intervals. In cases where policies are effected by creditors for a short-term of years in order to cover some advance made, they

are known as *short term policies*. Thus a creditor who effects a short term policy on the life of his debtor, has not only to pay a premium for a short term, but the premium itself is proportionately lower than that usually charged on a whole life policy.

An *annuity* is a policy under which the full amount is not payable on death but is payable yearly in smaller sums. An *indisputable policy* is one where the insurers are estopped from avoiding the policy on any ground except fraud. Section 45 of the Insurance Act of 1938 provides to the effect that after the lapse of two years a policy cannot be avoided for mis-statement except in the case of fraud. Partners may take out "*joint life policies*" in order to cover the inconvenience caused through a sudden withdrawal of capital by the death of one of the partners.

There are also what are known as "*sinking fund policies*", where policies are effected by payment of premiums yearly in order to secure a fund at the end of a certain term for the payment of debentures, etc., in connection with joint stock companies with a redeemable debenture debt.

Surrender Value

This is *the value which an insurance company assesses and which it is prepared to pay in case the assured desires to surrender his policy and extinguish his claim upon it*. Assurance companies generally pay surrender values only on those policies on which at least three full premiums have been paid. The *surrender values* are based on the *actual premiums paid*, and the condition is that the insured must have paid his premiums for a specific period usually from two to three years. As the duration of the policy increases, the assurance company allows a larger surrender value than in cases where a policy is surrendered within a shorter time. It is generally based on the difference between the cost of a new policy and the amount of the future premiums payable to keep the old policy alive.

The Insurance Act 1938 (S. 113) now makes provisions in this connection. In case of a policy under which the whole of the benefits become payable either on the occurrence, or at a fixed interval or intervals after the occurrence, of a contingency which is bound to happen, the Act provides that if all premiums have been paid for at least *three* consecutive years (five years in case of policy issued by provident societies) the policy shall acquire a *guaranteed surrender value*. The Act further provides that where a policy has acquired a surrender value, it will not lapse for non-payment of further pre-

miums but must be kept alive to the extent of the paid up sum insured unless such sum is less than Rs 100 or is an annuity of less than Rs 25 or unless the parties after the default agreed in writing to some other arrangement.

Loans on Policies

Facilities by way of advances on policies are generally offered after a certain number of premiums have been paid, say from two to three years, and within the limit of the surrender value. The loan may be repaid either as agreed, or at the convenience of the borrower, and in case it is not repaid it is kept on with interest accumulation, to be deducted when the policy is finally surrendered or falls due. From the standpoint of a life office there is no investment of a higher value than a loan on the security of the surrender value of their own policy and very favourable terms are offered.

SUMMARY

A Contract of Insurance: A contract of insurance is a contract by which the insurer, in consideration of a premium paid by the insured, undertakes to indemnify the insured against any loss arising from the happening of a specified event.

Essentials Elements of Insurance

- (1) Elements of a valid contract.
- (2) A contract of indemnity
- (3) Insurable interest
- (4) Utmost good faith (*uberrima fides*)
- (5) *Causa proxima*

Main Types of Insurance

- (1) Life
- (2) General, including fire, marine, accident, etc.

LIFE ASSURANCE

Definition: Life insurance is a contract by which the insurer, in consideration of a premium, undertakes to pay to the person for whose benefit the insurance is made, a sum of money on the death of the person whose life is insured.

Insurable Interest: A person cannot insure the life of another unless he has an insurable interest in it *i.e.*, he benefits by the existence of that life and would lose financially by its ceasing to exist.

A person has unlimited insurable interest in his own life. A husband is presumed to have insurable interest in his wife's life and *vice versa*.

A surety has insurable interest in the life of the principal debtor to the extent of his claim.

In life assurance the insurable interest must exist at the time of the contract of insurance.

Distinctions

Assignment

1. A transfer of the right of the policy holder to the assignee.
2. Cannot be revoked.

Nomination

1. A person is merely named to collect the amount to be paid by the insurer on the death of the insured.
2. Can be revoked.

Reinsurance

1. When the insurer, who feels that he has undertaken too high a risk, safeguards his position by reinsuring the same risk wholly or partly with other insurers.
2. No privity of contract between the insured and the reinsurer.

Double Insurance

1. When the insured insures the same risk with more than one insurer.
2. Privity of contract between the insured and all the insurers.

Types of Life Policies

- (1) Whole Life Policy
- (2) Endowment Policy
- (3) Annuity Policy
- (4) Limited Payments Policy
- (5) Ascending Scale Policy
- (6) Joint Life Policy
- (7) Short Term Policy
- (8) Sinking Fund Policy

Surrender Value: Surrender value is the amount that the insurer will pay to the assured if the latter wants to give up his rights on the policy to the insurer. The amount will depend on the premiums paid. To acquire a surrender value a certain number of premiums should have been paid.

TYPICAL QUESTIONS

1. Discuss with examples, the contract *uberrima fides*.

2. Define a contract of insurance and enumerate the essential characteristics of the contract.
3. Distinguish between nomination and assignment, and state the law relating to assignment of different kinds of insurance policy.
4. Answer the following giving reasons —
 - (a) *A* nominates *B* in 1940 to receive payment of the moneys on his policy of life insurance. In 1942 *A* assigns the policy to *C*. *A* dies in 1946. What are the respective rights of *B* and *C* under the insurance policy?
 - (b) *X* effects a policy on his life on 1st January, 1955, and gives his age as 25 years on that day. On 1st January, 1965, it is discovered that the age of *X* on the relevant date was 30 years. Can the insurer avoid the policy?
5. Write notes on:—
 - (a) Re-insurance;
 - (b) Surrender Value.

Chapter 19

Insurance— Fire

Definition

A CONTRACT of fire insurance is a contract by which the insurer undertakes, for a consideration in the form of a payment of money either in a lump or instalments, to *indemnify* the insured against the consequences of a fire, or the loss or injury as arising therefrom during an agreed period and upto a certain amount. The contract is to be found embodied in a document known as the “*policy of fire insurance*”, and is usually for a period of one year and renewed each year.

The provisions of the Insurance Act 1938 mentioned under “Life Assurance” section should also be read in connection with fire insurance as many of the provisions of the Act relate to fire insurance also.

Insurable Interest

Here also, as in the case of life and marine insurance, *the insured must have an insurable interest in the article insured, i.e., by loss, destruction, or damage of the property concerned he will suffer a pecuniary loss.*

In fire insurance the insurable interest must exist at the time of effecting the insurance as well as at the time of the loss. The interest, however, may be legal or equitable or may arise under a contract of purchase or sale.

The following have been held to have insurable interest in the subject matter:

(1) Owner, (2) Mortgagee, (3) Trustee, (4) Executor, (5) Warehouseman, (6) Common Carrier, (7) Bailee, (8) Pledgee, (9) Person in lawful possession, (10) Finder, (11) Insurer, (12) Commission agent, where the agency is coupled with interest and (13) Tenants who are liable to pay rent after a fire.

It should, however, be noted that persons with limited interest in the subject-matter can insure only to the extent of such limited interest.

The Policy

It has been held in various English cases that it is not necessary to have an actual formal policy in order to constitute a valid contract of fire insurance. *A slip initialled by a broker with a view to the preparation of a policy may be taken as a contract of insurance* and it has also been held that *a mere proposal to insure followed by an acceptance of the proposal in itself constitutes a valid contract of fire insurance even* though no payment by way of fire insurance premium has been made. The general practice is that after the proposal by the owner of the property for insurance and after its acceptance a document called "*cover note*" is handed to the insured. This cover note is given as a protection during the interval of time covered by the proposal and the consideration of that proposal by the insurer or underwriter. It has been held that such a cover note would be sufficient to enable the holder to claim damages should a fire occur during the interval. In short, the cover note or an *interim* protection note, constitutes a binding contract for the time mentioned in it.

The cover note may even date back the policy as in *Indian Trade and General Insurance Co. v. Bhailal*¹ where a cover note which was issued on June 18 insured the risk from June 15. When it was later discovered that unknown to both parties the goods had been destroyed by fire on June 16, *i.e.* before the issue of the cover note, it was held that the insurance company was liable and that the law

¹ 1954 Bom. 148

relating to mistake under Section 20 of the Contract Act did not apply.

The Risk

The risk on a fire policy commences from the moment of time the cover note or the deposit receipt, or the interim protection note is given and continues for the term covered by the contract of insurance. It is the practice to allow a certain number of days as *days of grace* within which a fire policy may be renewed after the expiration of the term. In such a case, if a fire should occur within this time the insured would be entitled to recover damages. The days of grace only apply when the insured has the intention to renew the policy, failing which, the policy expires on the day the period runs out. If, however, it is expressly stipulated in the policy that unless the renewal premium is paid and the renewal risk is accepted the insurance would expire, the insured would not be able to recover in a case where a fire occurs after the expiration of the term and before the acceptance by the fire insurance company of a proposal for further insurance.

Loss by Fire

The question as to what is the meaning of expression "*loss by fire*" has frequently arisen. Of course, the literal meaning, viz., damage, loss or deterioration through ignition is included, but much more than that is covered. In India the Special Municipal Acts of the different provinces lay down that damage by fire within the meaning of policies in India, would include any damage done in the exercise of powers, in case of an outbreak of fire, by a magistrate, or members or secretaries of committees, or members of a fire brigade by way of breakage, pulling down of premises and through any measures that may have to be taken in case of fire to preserve lives or property. The exact wording of the Bombay Municipal Corporation Act of 1888, Section 363, is as follows--

Any damage occasioned by the fire brigade in the due execution of their duties, or by any police or municipal officer or servant who aids the fire brigade, shall be deemed to be damage by fire within the meaning of any policy of insurance against fire.

It would also include the damage to a property caused through heating which heat has been engendered by some property near it which has caught fire. Of course, pure and simple heating, without there being any ignition of the property itself or anything near it, would not be covered by the expression "*loss or damage by fire*". In case of lightning, if the actual fire has been caused by such an

accident, it would, of course, be covered by the ordinary risk of damage by fire, but not otherwise, unless specifically provided for in the policy as is usually done. In short, *losses directly caused through fire, i.e. those that are direct consequences of fire, are covered. The others are not covered unless specifically provided for.* If the loss is caused through the malicious act of the insured himself he would not be able to recover it, but it would be no excuse for the underwriter to say that the loss was caused through the negligence of the insured.

Fire policies usually cover loss through fire whether caused through lightning, explosion of boilers used for domestic purposes or explosion of gas used for domestic purposes or in a building not used as gas works. They do not include loss through fire caused through spontaneous fermentation, earthquakes, subterranean fire, riot, civil commotion, foreign enemy, military or usurped power, rebellion or insurrection.

Types of Policies

Some of the more common types of fire policies are

- (1) Specific policy.
- (2) Valued policy.
- (3) Unvalued or Open policy.
- (4) Average policy.
- (5) Floating policy.

1. Specific Policy

A specific policy is one where the insurer undertakes to make good the loss upto the amount specified in the policy, irrespective of the value of the property. For example, if a property worth 2 lakhs is insured for Rs 1,00,000 but the actual loss is only Rs 75,000; the insured can recover the full loss *i.e.*, Rs 75,000. If, however, his loss is Rs 1,50,000 he can only recover Rs 1,00,000. In other words, he can recover the actual loss if it is equal to or less than the value of the policy but if his loss is more than the sum insured, he can recover only the amount of the policy.

2. Valued Policy

A valued policy usually taken where it is not easy to determine the value of the property, *e.g.*, antiques. In the case of total loss in a valued policy the insurer undertakes to pay the value of the property as mentioned in the policy, or the declared value, irrespective of its actual or market value.

3. Unvalued or Open Policy

Where the value of the subject matter is not specified in the policy it is known as an unvalued or open policy.

4. Average Policy

An average policy is a fire policy which includes an "Average Clause", *i.e.*, the insured is penalised for under-insurance of the property. For example, as we have already seen, in a specific policy, there being no average clause, the insured can claim up to the full amount of the policy even if he has under-insured his property. In an average policy, however, instead of the whole loss the amount which the insurer will pay in such proportion of the loss as the sum insured bears to the whole value of the policy.

5. Floating Policy

A floating policy covers loss on goods which are lying in different places, for example, a dealer may take out only one floating policy, instead of separate specific policies, for all his goods some of which may be in warehouses others in railway stations, shop counters, etc.

Absolute Good Faith

The contract of fire insurance is a contract uberrima fides, i.e., a contract based upon absolute good faith, and therefore, the insured must make full detailed disclosure of all material facts likely to affect the judgment of fire offices in determining the rates of premium or deciding whether the proposal should be accepted.

The description of the property, when asked for, should be correctly given, and all information that may be required as to the class of goods and articles that are kept on the premises or in the surrounding neighbourhood, should be accurately supplied.

Claims and Average

In case of an outbreak of fire the first care that the insured must take is to give notice to the insurance company. The policies generally provide for notice within a specified time of the outbreak which clause should be strictly complied with. The claim to be made out should be for the exact value of the goods damaged, or destroyed at the date of the fire. In the case of goods partly destroyed or damaged, details as to their value in good condition (and in damaged condition) ought to be made out and furnished to the insurance company. In the case of damage to buildings, the basis

of the claim should be the cost of repairs of the damage, with due allowance for the greater value of the new premises over the old. This is, of course, applicable where the policy covers the full value of the property; but in *fire insurance the peculiarity is*, unlike marine insurance, that the insurance company cannot, where the property is partially insured, claim to pay only a proportional loss, *i.e.*, loss in the proportion in which the amount insured stands to the full value of the property. The company is in fact liable for the whole loss, as far as the amount insured covers that loss, irrespective of the value of the whole property; *e.g.*, if a property is worth Rs 50,000 and is insured for Rs 2 000, and the damage has been caused to the extent of Rs 5,000, the insured can cover his full Rs 5,000. Policies, however, as we have seen, counteract this advantage from the point of view of the insured by inserting clauses known as "*average clauses*" under which it is expressly provided that in such cases the loss in proportion to the risk covered on the property can only be claimed. These average clauses have now developed into a number of variations suitable to various circumstances. It may be added here that the fire offices by inserting a clause called "*reinstatement clause*" reserve to themselves the right to reinstate the property instead of paying in money. This clause goes a long way in practice to prevent rapacious and fraudulent claims being presented.

Subrogation

Subrogation is *a doctrine applicable to both fire and marine insurance*, by which the insurer or the underwriter, becomes entitled on his paying compensation to the insured, to claim the advantage of every right of the insured against third parties who may be proved to be responsible for that loss, owing to such third parties' negligence, default, etc. In the words of Brett, L. J.: "As between the underwriter and the assured, the underwriter is entitled to the advantage of every right of the assured, whether such right consists in contract, fulfilled or unfulfilled, or in remedy for tort capable of being insisted on, or already insisted on, or in any other right, whether by way of condition or otherwise, legal or equitable, which can be or has been exercised or has accrued, and whether such right could not be enforced by the insurer in the name of the assured by the exercise or acquiring of which right or condition the loss against which the assured is insured can be, or has been, diminished".²

² *Cosettlain v. Preston* (1883) II Q.B.D., p. 388

To take an instance, it often happens that a lessee takes a lease of premises for a long period, the lease covering repairs to the premises. The lessee under this covenant would be bound to repair the premises even in the case of damage by fire. Now, if, the premises have been insured by the landlord and a fire occurs, the landlord can recover the loss immediately from the insurance company or the insurer or the insurance company can in their turn recover the amount from the lessee, because, on their having paid the loss to the lessor, *i.e.* the landlord, the landlord's rights are subrogated to the insurer.

Assignment of Fire Policy

A fire policy can, according to English Common Law, be assigned only with the consent of the insurer or the insurance company. It is said to be a contract of a personal nature, and therefore a policy of insurance does not pass with the sale or assignment of the property on which it is effected. A transfer or assignment with the consent of the insurance office, as stated above, would give an effective right to the assignee. In connection with this, Sections 135A and 49 of the Transfer of Property Act, 1882. are important.

Section 135A requires only an *endorsement* or any other writing in the case of assignment of immovable property which has been insured against fire. Notice is only necessary to make the insurer liable to the assignee if the insurer pays the insurance money to the insured after receiving notice of the assignment. Thus notice is not necessary for a valid assignment of a fire policy.

Section 49 deals exclusively with *immovable property*. Here our *Indian law differs from the English*. Here unlike English law, the policy virtually passes to the purchaser on the transfer of the insured property since a transferee for value of an immovable property insured against fire is empowered to compel the transferor to apply any money received by him under a fire policy, to reinstate the property.

SUMMARY

Definition: A contract of fire insurance is a contract by which the insurer undertakes, for a money consideration, to indemnify the insured against the consequences of a fire during an agreed period up to the amount stated in the policy.

Essentials or Characteristics of a Fire Policy

(1) A contract of indemnity.

- (2) Insurable interest to exist both at the time of effecting the insurance as well as at the time of the loss.
- (3) Utmost good faith or *unberrima fides*.
- (4) Loss through fire.
- (5) A contract from year to year.
- (6) Subject to principles of subrogation and contribution.

Types of Fire Policies

- (1) Specific.
- (2) Valued.
- (3) Unvalued or Open.
- (4) Average.
- (5) Floating.

Assignment of a Fire Policy: By endorsement or any other writing.

TYPICAL QUESTIONS

1. What is meant by insurable interest in a contract of Fire Insurance? How can a Fire Policy be taken out and from what moment of time does the risk in it begin to run?

2. What is meant by "Insurable Interest", "Policy", "Reinsurance", "Double Insurance", "Subrogation", "Loss by Fire"?

3. "A contract of fire insurance is a contract based upon the utmost good faith." Comment on this observation.

4. A insured for Rs 20,000 his house worth Rs 50,000 against fire. The house was damaged by fire and the total loss is estimated at Rs 15,000. What amount can A recover from the Insurance Company?

5. A is insured against loss or damage by fire. A fire breaks out in his premises and he attempts to save his furniture and valuables by removing them from the premises. Some of these are damaged whilst being removed or thrown out of the window and some are stolen whilst lying in the street. Can he recover for this damage and loss under the policy? Explain fully the reason for your answer.

6. What is the value of an 'average clause' in a policy of the insurance?

N insured against fire his house worth Rs 2,00,000 for Rs 1,00,000. The house is partially burnt and the damage done to it is Rs 8,000. N claims Rs 8 000 from the underwriters who offer to pay Rs 4,000. How will you decide N's claims?

7. Discuss the doctrine of subrogation in relation to fire and marine insurance.

Chapter 20

INSURANCE— MARINE

Definition

A CONTRACT of marine insurance is defined by the Marine Insurance Act, 1963, as “an agreement whereby the insurer undertakes to indemnify the assured, in the manner and to the extent thereby agreed, against marine losses, that is to say, losses incidental to marine adventure” (S. 3). The instrument in which the contract of marine insurance is contained is called a policy. *The insurer in marine insurance is known as the underwriter or insurer* and the person who is thereby indemnified is called the insured.¹

Insurable Interest

The essence of a marine insurance contract is that it is a *contract of indemnity*. This means that by this contract the *underwriter* agrees to indemnify the insured against losses by sea risks to the extent of the amount insured. The insured in return for this undertaking pays an agreed amount known as the *premium*. In order, therefore, to suffer a loss the party who insures a particular property must have what is called *insurable interest* in the same, *i.e.*, such an interest that in case of loss or damage to the thing insured, the

¹ [Reference to sections in this chapter are to those of the Marine Insurance Act, 1963 (No. 11 of 1963) which came into force on 1st August 1963].

insured must suffer a pecuniary loss. The Marine Insurance Act, 1963, states in this behalf that "every person has an insurable interest who is interested in a marine adventure". It further adds that "a person is interested in a marine adventure where he stands in any legal or equitable relation to the adventure or to any insurable property at risk therein, in consequence of which he may benefit by the safety or due arrival of insurable property, or may be prejudiced by its loss, or by damage thereto, or by the detention thereof, or may incur liability in liability in respect thereof." (S.7)

Every lawful marine adventure may be subject of a contract of marine insurance. "Marine adventure" is defined by the Act to include any adventure where—

- (i) any insurable property is exposed to maritime perils,
- (ii) the earnings or acquisition of any freight, passage money, commission, profit or other pecuniary benefit, or the security for any advances, loans, or disbursements is endangered by the exposure of insurable property to maritime perils,
- (iii) any liability to a third party may be incurred by the owner of, or other person interested in or responsible for, insurable property by reason of maritime perils; [S. 2(d)].

The assured must be interested in the subject-matter insured *at the time of the loss*, (S.8). Where such insurable interest is absent, the contract is deemed as void by way of wagering (S.6).

Where the subject-matter is insured *lost or not lost*, the assured may recover although he may not have acquired his interest until after the loss, unless at the time of effecting the contract of insurance the assured was aware of the loss, and the insurer was not (S. 8)

The owner of the ship or cargo has an insurable interest in it; a creditor who has advanced money on such a ship or cargo has an insurable interest to the extent of his claim; a trustee holding anything in trust for another has an insurable interest in such property; an assignee of a bill of lading may insure to the extent of his interest; a shipowner has an insurable interest in the freight unpaid; a consignee or a factor, or agent may have an insurable interest in the ship or the cargo on the safe arrival of which the payment of his brokerage depends, a mortgagor has an insurable interest to the full value of the property while the mortgagee has an insurable interest to the extent of the sum due to him, etc.

How Marine Insurance is Effected

Before considering the form of the policy of marine insurance generally accepted all over the maritime world, we might consider the manner in which insurance is generally effected in England and in India. *In England*, besides the large marine insurance companies with which we are quite familiar in India, the greatest proportion of the business of marine insurance is done by private underwriters who are members of insurance associations like the Corporation of Lloyds.

The origin of Lloyds was a coffee house by that name where persons who had merchandise or ships at sea to insure found it most convenient to call as they would be sure to find there some merchants who were ready to underwrite the risk.

As marine insurance business progressed it was found that side by side with legitimate underwriters doing legitimate business, a large number of irresponsible outsiders indulged in illicit gambling. To prevent the business from getting a bad name, responsible underwriters and brokers banded themselves in 1771 by forming an association known as the Association of Lloyd's Underwriters. The association afterwards (1774) took up its quarters in the Royal Exchange as increase in business made a more official centre desirable. Subsequently in 1928 it was moved to its present position in Leadenhall Street. After a most successful career the association was incorporated in 1871 by an Act of Parliament as "The Corporation of Lloyds". It will be seen that the name "Lloyds" was maintained as it had acquired a prestige through the standing of a large number of years. The object of the association is:—

- (1) promotion of the interests of members, and
- (2) collection and distribution of shipping intelligence among them.

Underwriting and Non-underwriting Members

The members of Lloyd's have to pay an entrance fee and a yearly subscription. They are divided into two classes, viz., underwriting and non-underwriting members. The underwriting members do insurance business on their own account by underwriting policies, whereas, the non-underwriting members, or brokers, act as middlemen between the underwriters and the outside public. There are many members who act as both brokers and underwriters, and in many cases one member of a firm of underwriters acts as a broker whereas the other acts as underwriter. The hall of Lloyd's where

the members meet for business is called "the room", to remind them of the old Coffee House where they had engaged a room for their business.

Business at "Lloyds"

Lloyd's have agents all the world over who cable from time to time as to the arrival and departure of steamers hour by hour, also about casualties, wrecks, collisions, etc. This news is displayed at the allotted places in the "Room". It is also printed in the *Lloyd's List*. It is then entered in a special index which is kept in Lloyd's Room, so that any member by simply opening out the pages relating to the name of the vessel concerned, can find out all details as to its movements, etc.

In England a large proportion of business of marine insurance is done on Lloyd's through private underwriters. Large insurance companies which have been floated at a subsequent stage of the history of marine insurance in England do comparatively a very small proportion of business. The oldest of these companies are the London Assurance Corporation and the Royal Exchange Assurance Corporation, both of which were floated in 1720, by special Acts of Parliament. It was at one time thought that these insurance companies and many others that followed would, in course of time, take away from the members of Lloyd's the bulk of marine insurance business. This fear, however, has proved ill-founded and the members of Lloyd's are flourishing better than even in spite of these and other insurance companies competing with them. The reason is that the quotation of the members of Lloyd's compare favourably with those of insurance companies, as the latter have to maintain large establishments.

We shall now consider how business is done on Lloyd's. A person wishing to insure at Lloyd's has to engage an insurance broker who has to go to the "room" and carry out the order. The broker receives instructions from the would-be insured and effects the insurance by communicating that fact to the underwriter on Lloyd's. When the broker effects the insurance with a private underwriter he gets a temporary document made out known as the "slip", which consists of a simple statement as to the name of the ship, date, description of the risk, the sum or sums insured and the rate of premium. The underwriters who undertake the risk as mentioned in the slip initial it, each for the sum he thinks proper to underwrite, until the whole amount is subscribed. *The legal effect of the slip as described by Justice Blackburn in Ionides v. Pacific Fire and Marine*

*Insurance Co.*¹ is as follows: "The slip is in practice and according to the understanding of those engaged in marine insurance, complete and final contract between the parties, fixing the terms of insurance and the premium, and neither party can, without the assent of the other, deviate from the terms thus agreed without a breach of faith, for which he would suffer in his credit and future business". However, subsequent Acts introduced in England have clearly laid down that *valid contracts of marine insurance can only be entered into by means of instruments known as policies which should be duly stamped*. It would therefore follow that a "slip", as it is not stamped, would not be a valid contract aimed at by the English law. On the "Lloyd's", however, a slip initialled by a member of the "Lloyds" would be binding on the member as per the rules of the "Lloyd". It has been further held that where a stamped policy has been made out and executed after a slip, the slip may be looked into for the purpose of ascertaining the *intention* of the parties to the policy. It has, however, been held that if the contract of insurance is made in a country where no stamp laws are enforced, an action may be maintained upon an agreement to issue a policy, and a specific performance of it may be ordered.²

On the slips certain abbreviation may appear, e.g. "F.G.A." "F.C.S.", or "F.C. & S.", and "R.D.C." "*Foreign General Average*" ("F.G.A.") means that the arrangement is that in case of a General Average Claim (which has been explained later) which may arise under the policy, the average settlement made in a foreign country will be adopted as the basis for settlement. "*Free of Capture & Seizure*" ("F.C.S." or "F.C. & S."), which is generally inserted in times of war, means that the underwriters will not be liable for loss or claim arising from seizure of ship as a prize of war. In times of war this clause is inserted unless the insured pays the underwriter additional premium for "War Risks". The "*Running Down Clause*" ("R.D.C.") evidences an arrangement whereby in case the ship collides with another ship and the Court finds it to be the wrongdoer, the underwriters would pay a part of the sum that the owner of the ship may be required to pay as damages and law costs "*Free of Particular Average*" ("F.P.A.") clause restricts the liability of the underwriter and the underwriter is liable only for total loss and not for particular average or partial loss.

¹ 1871 L R. 6 Q.B. 674

² *Bhogwandas v. Netherlands Indian Sea and Fire Insurance Co. of Batavia* (1858), 14 App. Cas 83, P.C.

Inchmaree Clause

The "*Inchmaree clause*" was introduced as a result of the decision in respect of a ship called *inchmaree*. In that case, while water was being pumped into the boilers of a ship at anchor, off shore, it was forced back as a closed valve disabled the ship's pump. It was held by the House of Lords that the damage was not covered by "the perils of the sea."⁴ Now, the "*Inchmaree clause*" which is now usually included in the policy covers losses caused (1) by the negligence of the master, the mariners, engineers and pilots, during loading or unloading or (2) through explosions, or bursting of boilers or (3) through latent defect in machinery or hull. Thus where the "*Inchmaree Clause*" is included, the insurer is liable even for what is not considered a "sea peril" nor *ejusdem generis* to a "sea peril".⁵

Cover Note

Very often, instead of a ship being made out by the broker or the underwriter, the insurance companies make out in their own offices a document called a *cover note* or *insurance note*, containing a sketch of the insurance or a memorandum which is to serve as a first step in the drawing up of a proper document in the form of a policy. Of course, these documents contain incomplete information which can only be explained when read in connection with a regular policy of insurance. Unless these documents are properly stamped, they would not constitute a contract.

Implied Warranties in Marine Insurance

A *warranty* in marine insurance is different from a warranty under the Sale of Goods Act. In marine insurance a warranty means a stipulation or term the breach of which entitles the insurers to avoid the policy altogether and this is so even though the breach arises through circumstances beyond the control of the warrantor. Warranties may be *express* or *implied*. There are certain warranties which are implied in every contract of marine insurance unless they are expressly excluded. These are (1) warranty of sea-worthiness; (2) warranty of non-deviation; and (3) warranty as to the legality of the voyage. Besides this, it is the first duty of the insured that he should make full and fair disclosure of all material facts to the underwriters at the time they take over risk to enable them to clearly

⁴ *Thames & Mersey Marine Insurance Co. v. Hamilton Fraser & Co.*, 1887, 12 A C. 484

⁵ *Home Insurance Co. Ltd. N.Y. v. Ramnath & Co.*, 1955, 25 Comp Cas, (Ins.) P. 19.

know the nature of the risk itself so that a correct rate of premium may be charged. If the insured fails to do so the policy may be avoided by the underwriters. This is because contracts of insurance are contracts *uberrima fides*, contracts of absolute faith.

1. Seaworthiness

In a voyage policy the Insured, at the time of effecting the insurance, is supposed to give a warranty of seaworthiness, *i.e.*, at the time of insurance the ship concerned is in every respect fit for the voyage on which it is sailing. For example, the ship must be sound as regards her hull, the gear must be sufficient and she must be fully equipped provisioned and manned. She must not be overloaded. However, in a time policy there is no implied warranty that the ship shall be seaworthy at any stage of the adventure, but where, with the privity of the assured, the ship is sent to sea in an unseaworthy state, the insurer is not liable for any loss attributable to unseaworthiness (S. 41).

2. Non-Deviation

In case of a voyage policy where a voyage is contemplated between any two given ports, there is an implied warranty of non-deviation on the part of the insured, by which the insured is supposed to give an undertaking that the ship shall take the usual route taken by navigators, and shall not deviate therefrom except in cases where it is excusable by the law. If the ship, without lawful excuse, deviates from the voyage contemplated by the policy, the insured is discharged from liability as from the time of deviation. It is immaterial in such a case that the ship may have regained her route before any loss occurs.

Such a deviation exists—

- (a) where the course of the voyage is specifically designated by the policy, and that course is departed from; or
- (b) where the course of the voyage is not specifically designated by the policy, but the usual and customary course is departed from.

The intention to deviate is immaterial. There must be deviation in fact to discharge the insurer from his liability under the contract (S. 48).

However deviation or delay in prosecuting the voyage is excused:

- (a) where authorised by any special term in the policy;

- (b) where caused by circumstances beyond the control of the master and his employer;
- (c) where reasonably necessary in order to comply with an express or implied warranty;
- (d) where reasonably necessary for the safety of the ship or subject-matter insured;
- (e) for the purpose of saving human life or aiding a ship in distress where human life may be in danger;
- (f) where reasonably necessary for the purpose of obtaining medical or surgical aid for any person on board the ship; or
- (g) where caused by the barratorious conduct of the master or crew, if barratry be one of the perils insured against.

As soon as the cause excusing the deviation or delay ceases to operate, the ship must resume her course, and prosecute her voyage, with reasonable despatch (S. 51).

3. *Legality of The Voyage*

There is an implied warranty on the part of the insured that the adventure insured is a lawful one, and that, so far as the assured can control the matter, the adventure shall be carried out in a lawful manner. (S. 43).

It must be added here that over and above the express clauses and stipulations contained in the policy, the parties are bound by all the established usages of trade and navigation affecting marine insurance which they are taken to have known.

Policy of Insurance

A policy of insurance may be either (1) a *valued policy*, i.e. a policy which specifies the agreed value of the subject-matter insured, S. 29 or (2) an *open unvalued policy*, which does not specify the value of the subject-matter insured, which has, therefore, to be ascertained subsequently at the time the claim arises S. 30, or (3) a *time policy*, which covers the risk up to a stated amount for a fixed time, S. 27 or (4) a *floating policy*, which describes the insurance in general terms and leaves the name of the ship or ships or other particulars to be defined by subsequent disclosure, (S. 31), or (5) a *voyage policy* which covers a particular voyage, (S. 27) or (6) a *mixed policy*, which covers voyages between specified places which must be made within a specified time. (S. 27).

The Marine Insurance Act, 1963, specifically provides that a contract of marine insurance shall not be admitted in evidence

unless it is embodied in a marine policy in accordance with the Act. The policy may be executed and issued either at the time when the contract is concluded, or afterwards. (S. 24).

A marine policy must specify—

- (1) the name of the assured, or of some person who effected the insurance on his behalf;
- (2) the subject-matter insured and the risk insured against;
- (3) the voyage, or period of time, or both, as the case may be, covered by the insurance;
- (4) the sum or sums insured;
- (5) the name or names of the insurer or insurers. (S. 25).

A marine policy must be signed by or on behalf of the insurer. Where a policy is subscribed by or on behalf of two or more insurers, each subscription, unless the contrary be expressed, constitutes a distinct contract with the assured.

SCHEDULE FORM OF POLICY

BE IT KNOWN THAT

as well in

own name as for and in the name and names of all and every other person or persons to whom the same doth may, or shall appertain, in part or in all doth make assurance and cause and them, and every one of them, to be insured lost or not lost, at and from upon any kind of goods and merchandises, and also upon the body, tackle, apparel, ordnance, munition, artillery, boat and other furniture, of and in the good ship or vessel called the

whereof is master for this present voyage

or whosoever else shall go for master in the said ship or by whatsoever other name or names the said ship, or the master thereof, is or shall be named or called; beginning the adventure upon the said goods and merchandises from the loading thereof aboard the said ship,

upon the said ship etc.

and so

shall continue and endure, during her abode there, upon the said ship etc.

And further, until the said ship, with all her ordnance, tackle, apparel, etc., and goods and merchandises whatsoever shall be arrived at

upon the said ship, etc., until she hath moored at anchor twenty-four hours in good safety; and upon the goods and merchandises, until the same be there discharged and safely landed. And it shall be lawful for the said ship, etc., in this voyage to proceed and sail to and touch and stay at any ports or places whatsoever without prejudice to this insurance. The said ship, etc., goods and merchandises, etc., for so much as concerned the assured by a agreement between the assured and assurers in this policy, are and shall be valued at

Touching the adventures and perils which we the assurers are contented to bear and do take upon us in this voyage; they are of the seas, men of war, fire, enemies, pirates, rovers, thieves, jettisons, letters or mart and countermart, surprisals, takings at sea, arrests, restraints, and detrainments of all kings, princes, and people, of what nation, condition, or quality soever, barratry of the master and mariners, and of all other perils, losses and misfortunes that have or shall come to the hurt, detriment, or damage of the said goods and merchandises, and ship, etc. or any part thereof.

And in case of any loss or misfortune it shall be lawful to the assured, their factors, servants and assigns, to sue, labour, and travel for, in and about the defence safeguards and recovery of the said goods and merchandises and ship, etc., or any part thereof, without prejudice to this insurance; to the charges whereof we, the assurers, will contribute each one according to the rate and quantity of his sum herein assured.

And it is especially declared and agreed that no acts of the insurer or insured in recovering, saving, or preserving the property insured shall be considered as a waiver, or acceptance of abandonment. And so we, the assurers, are contented, and do hereby promise and bind ourselves, each one for his own part, our heirs, executors, and goods to the assured, their executors, administrators, and assigns, for the true performance of the premises, confessing ourselves paid the consideration due unto us for this assurance by the assured, at and after the rate of.

In witness whereof we, the assurers, have subscribed our names and sums assured in.

MEMORANDUM N.B.— Corn, fish, salt, fruit, flour, and seed are warranted free from average, unless general or the ship be stranded, sugar, tobacco, hemp, flax, hides and skins are warranted free from average, under five per cent, and all other goods also the ship and freight, are warranted free from average, under three per cent, unless general, or the ship be stranded.

RULES FOR CONSTRUCTION OF POLICY

The following are the rules referred to by this Act for the construction of a policy in the above or other like form, where the context does not otherwise require:—

Lost or not lost.—(1) Where the subject-matter is insured “lost or not lost” and the loss has occurred before the contract is concluded, the risk attaches unless at such time the assured was aware of the loss, and the insurer was not.

From—(2) Where the subject-matter is insured “from” a particular place, the risk does not attach until the ship starts on the voyage insured.

At and From.—(3) (a) Where a ship is insured “at and from” a particular place and she is at that place in good safety when the contract is concluded, the risk attaches immediately.

(b) If she be not at that place when the contract is concluded, the risk attaches as soon as she arrives there in good safety, and, unless the policy otherwise provides, it is immaterial that she is covered by another policy for a specified time after arrival.

(c) Where chartered freight is insured "at and from" a particular place, and the ship is at that place in good safety when the contract is concluded, the risk attaches immediately. If she be not there when the contract is concluded, the risk attaches as soon as she arrives there in good safety.

(d) Where freight, other than chartered freight is payable without special conditions and is insured "at and from" a particular place, the risk attaches *pro rata* as the goods or merchandise are shipped; provided that if there be cargo in readiness which belongs to the ship-owner, or which some other person has contracted with him to ship, the risk attaches as soon as the ship is ready to receive such cargo.

From the loading thereof.—(4) Where goods or other movables are insured "from the loading thereof" the risk does not attach until such goods or movables are actually on board, and the insurer is not liable for them while in transit from the shore to the ship.

Safely landed.—(5) Where the risk on goods or other movables continues until they are "safely landed" they must be landed in the customary manner and within a reasonable time after arrival at the port of discharge, and if they are not so landed the risk ceases.

Touch and stay.—(6) In the absence of any further licence or usage, the liberty to touch and stay "at any port or place whatsoever" does not authorise the ship to depart from the course of her voyage from the port of departure to the port of destination.

Perils of the Seas.—(7) The term "perils of the seas" refers only to fortuitous accidents or casualties of the seas. It does not include the ordinary action of the winds and waves.

Pirates.—(8) The term "pirates" includes passengers who mutiny and rioters who attack the ship from the shore.

Thieves.—(9) The term "thieves" does not cover clandestine theft or a theft committed by any one of the ship's company, whether crew or passengers.

Restraint of Princes.—(10) The term "arrest, etc., of kings, princes, and people" refers to political or executive acts, and does not include a loss caused by riot or by ordinary judicial process.

Barratry.—(11) The term "barratry" includes every wrongful act wilfully committed by the master or crew to the prejudice of the owner, or, as the case may be, the character.

All other perils.—(12) The term "all other perils" includes only perils similar in kind to the perils specifically mentioned in the policy.

Average unless general.—(13) The term "average unless general" means a partial loss of the subject-matter insured other than a general average loss, and does not include "particular charges".

Stranded.—(14) Where the ship has stranded, the insurer is liable for the excepted losses although the loss is not attributable to the stranding, provided, that when the stranding takes place the risk has attached and, if the policy be on goods, that the damaged goods are on board.

Ship.—(15) The term "ship" includes the hull, material and outfit, stores and provisions for the officers and crew, and, in the case of vessels engaged in a special

trade, the ordinary fittings requisite for the trade, and also, in the case of steamship the machinery, boilers, and coals and engine stores, if owned by the assured and also in the case of a ship driven by power other than steam, the machinery and fuels and engine stores, if owned by the assured.

Freight.—(16) The term “freight” includes the profit deliverable by a shipowner from the employment of his ship to carry his own goods or movables as well as freight payable by a third party, but does not include passage money.

Goods.—(17) The term “goods” means goods in the nature of merchandise, and does not include personal effects or provisions and stores for use on board.

In the absence of any usage to the contrary, deck cargo and living animals must be insured specifically, and not under the general denomination of goods.

RE-INSURANCE

An underwriter or an insurance company may, *when the risk is considered too great, get a part reinsured with another underwriter or insurance company.* The insurer has an insurable interest in his risk which he may reinsure. Unless otherwise provided by the policy, the original assured has no right or interest in respect of such reinsurance, (S.11). This reinsurance does not affect the position of the original insured, for *the original insurance remains a distinct contract by itself* and the reinsurance in its turn forms equally a distinct contract between the second set of parties. *The original insured, therefore has no claim on the reinsurance contract but can only claim from his own underwriter.* To take an illustration, supposing *A* gets his ship insured with *B* for Rs 10,000 for a certain premium. Now, if *B*, the underwriter, wishes to reinsure half the risk, he may reinsure with *C*, for, say, Rs 5,000. In case of loss, *A* can only put in a claim against *B*, but he has no right against *C*, *B* has to pay his claim half the loss from *C*. If, therefore, *B* were to fail and *A*'s claim is not paid, *A* cannot claim the reinsured amount from the underwriter *C* with whom the reinsurance was effected. *C* is liable to pay in such an event only to *B*'s trustee in bankruptcy.

Arnold in his work on Marine Insurance defines reinsurance as—

“A contract by which, in consideration of a certain premium, the original insurer throws upon another the risk for which he has made himself responsible to the original assured, to whom, however, he alone remains liable on the original insurance”.

It has also been laid down that the original underwriter need not give a notice of abandonment to the reinsurer. This is now expressly provided by the Marine Insurance Act, 1963, also [S. 62(9)]. *The doctrine of subrogation applies equally to a reinsurance of the*

original insurance. It may be added that the insured may also have his risk insured against the insolvency of the underwriter with whom he has effected an insurance, in case events happen which cast some doubt in his mind as to the ultimate solvency of that person.

DOUBLE INSURANCE

Double insurance is quite distinct from reinsurance. Here, the insured effects more than one insurance. If he does so without any fraudulent intent, he can recover on all the policies. If the total amount of all the policies taken together comes to more than the actual value of the subject-matter insured, the insured can only recover the actual value. He can recover the full value on the original policies till his total loss is made up (S. 34). If, for example, a merchant not knowing the actual value of his goods insures them for an approximate amount, and then thinking that amount is not sufficient to cover the risk, effects a second insurance, he can do so. Now when the loss occurs, he may recover as much of it as he can, from the first policy, and if that does not satisfy his claim, he may proceed to recover the balance on the other policy. The underwriters may, thereafter, adjust their contribution among themselves.

The above rule applies when one party with the same interest insures it by effecting more than one policy. It often happens that two or more parties, with distinct interests in the same property, insure the property separately on their own account, each up to its full value. In such a case each would be entitled to recover the full amount of his claim based on separate interests.

Lord Mansfield, while dealing with this rule of contribution, in case of *over-insurance* laid down as follows—

“In case of *over-insurance*, the different sets of policies are considered as making but one insurance and are good to the extent of the value of the effects put in risk; the assured can recover on the different policies, no more than their value, but he may sue the underwriters on any of the policies, and recover from those, he so sues, to the full extent of his loss, supposing it to be covered by the policy on which he elects to sue, leaving the underwriters out that policy to recover a rateable sum by way of contribution from the underwriters of the other policy”.⁶

Hence, where a merchant, the value of whose whole interest was £22,001, first effected a policy on his interest at Liverpool for £17,001, and then without fraud another policy on the same interest at London for £22,001, he was allowed to recover the whole amount on the London policy, and the London underwriters were allowed to

⁶ *Newby v. Reid* (1763). 1 W. Bl. 416.

recover a rateable amount by way of contribution from the Liverpool underwriters.⁷

LOSSES

The losses of insurance may be either (1) *partial*, or (2) *total*; and the total losses are again sub-divided into (a) *actual total loss*, and (b) *constructive total loss*. A *partial loss* arises where the subject-matter insured is damaged only partially, or where it is not damaged at all but a contribution by way of general average is reserved.

Actual Total Loss

With regard to total losses an *actual total loss arises when the subject-matter insured is destroyed, or so damaged as to cease to be a thing of the kind insured, or where the assured is irretrievably deprived thereof, so that it is beyond the powers of the assured party to recover it*, as where in one case a ship ran on an island and was wrecked and the goods thereon were plundered by savages who lived there, it was declared to be an actual total loss. This Act gives an example where the ship concerned in the adventure is missing, and after the lapse of a reasonable time no news of her has been received, an actual total loss may be presumed (S. 58).

Constructive Total Loss

This loss arises when the thing insured though not wholly destroyed is reduced to such a state or is placed in such position, that *to get it repaired would be most expensive and no prudent businessman would care to do so, or its ultimate safety would be most doubtful*. The Act provides that there is a constructive total loss "where the subject-matter insured is reasonably abandoned on account of its actual total loss appearing to be unavoidable, or because it could not be preserved from actual total loss without an expenditure which would exceed its value when the expenditure had been incurred".

It adds that in particular, there is a constructive total loss—

- (i) where the assured is deprived of the possession of his ship or goods by a peril insured against, and
 - [a] it is unlikely that he can recover the ship or goods as the case may be
 - or

⁷ *Roger v. Davls and Davls v. Gildari* (1696), 2 Park, Ins. 601-2.

- [b] the cost of recovering the ship or goods, as the case may be, would exceed their value when recovered; or
- (ii) in the case of damage to a ship, where she is so damaged by a peril insured against that the cost of repairing the damage would exceed the value of the ship when repaired.

In estimating the cost of repairs no deduction is to be made in respect of general average contributions to those repairs payable by other interests, but account is to be taken of the expense of future salvage operations and of any future general average contributions to which the ship would be liable if repaired; or

- (iii) in the case of damage to goods, where the cost of repairing the damage and forwarding the goods to their destination would exceed their value on arrival (S. 60).

Cases of a constructive total loss may be multiplied. The other instance is where a ship is captured by the enemy and though the same may not be confiscated, the probabilities are that it may never return safe. In *Macbeth & Co v. Maritime Insurance Co.*⁸ it has been laid down that the insured is entitled to add the cost of repairs to the value of the ship in determining the amount claimable. According to Arnold on *Marine Insurance*,

“there is a case of constructive total loss, where the subject-matter though not totally destroyed, its destruction is rendered highly probable, and its recovery though not utterly hopeless, yet exceedingly doubtful”.

Abandonment

In the case of an actual total loss no notice of abandonment need be given (S. 57). When there is a case of constructive total loss, the insured can abandon the property and must in that case give notice to the underwriters, called “*notice of abandonment*”, thereby *rescinding all his rights to the recovery of the property and claiming an indemnity as for a total loss*. If he fails to do so, the loss can only be treated as a partial loss [S. 62(1)]. Thus if any part of the property is recovered or saved thereafter, the underwriter who has paid as for a total loss gets it as a salvage to which he is entitled. It may be added here; that the “*notice of abandonment*” must be absolute and not conditional as the insured must, in order to obtain his indemnity, absolutely transfer his ownership. If it answers these requirements, it may be either oral or written, and no special form is necessary. Notice of abandonment must be given with reasonable diligence after the receipt of reliable information of the loss, where, however, the information is of a doubtful character the assured is entitled to a reasonable time to make enquiry. If notice of abandonment is properly given, the rights of the assured are not prejudiced by the

⁸ (1808) A.C. 144

fact that the insurer refuses to accept the abandonment. Again, the acceptance of an abandonment may be either express or implied from the conduct of the insurer. The mere silence of the insurer after notice is not an acceptance. Where notice of abandonment is accepted, the abandonment is irrevocable. The acceptance of the notice conclusively admits liability for the loss and the sufficiency of the notice. Notice of abandonment is unnecessary where at the time when the assured receives information of the loss, there would be no possibility of the benefit to the insurer if notice were given to him. Again, notice of abandonment may be waived by the insurer (S. 62).

Subrogation

The doctrine of subrogation *applies equally to marine insurance and fire insurance, as well as to all contracts of indemnity generally.* It lays down the principle which is quite equitable viz. that in cases of contracts of insurance such as marine and fire insurance, where a loss occurs, and the underwriters pay as for a total loss, they, the under-writers step into the shoes of the insured with regard to all the rights and remedies that the insured may have had against the third party and with regard to any benefit arising therefrom. To take an illustration, supposing that a ship called *India* was insured for £ 5,000 and it was lost through collision with another ship called *Egypt*. If the underwriters paid the owners of *India* an indemnity of £ 5,000 as per the policy, they acquire a right as per this doctrine of subrogation to sue the owner of the *Egypt* for damages in case the collision was due to the fault of the master of the *Egypt*. They can bring this action in the name of the owner of the *India* and if they succeed in obtaining judgment in their favour they are solely entitled to the amount awarded by the Court.

The Marine Insurance Act, 1963 provides in his behalf that where the insurer pays for a total loss either of the whole, or in the case of goods of any apportionable part, of the subject-matter insured, he thereupon becomes entitled to take over the interest of the assured in whatever may remain of the subject-matter so paid for and he is thereby subrogated to all the rights and remedies of the assured in and in respect of that subject-matter as from the time of the casualty causing the loss. Subject to this, where the insurer pays for a partial loss, he acquires no title to the subject-matter insured, or such part of it as may remain. He is however thereupon subrogated to all rights and remedies the assured in and in respect of the

subject-matter insured as from the time of the casualty causing the loss, in so far as the assured has been indemnified, according to the Act, by such payment for the loss (S 79).

The difference between abandonment and subrogation lies principally in that, in case of abandonment there must be a total loss, whereas in case of subrogation, whether the loss is total or partial, in fact, however, small, it would apply, and the party to a contract of indemnity who is called upon to pay, has the right to claim to be reimbursed. Again, the underwriter cannot get any further advantage or better advantage than the insured is entitled to, because all he is entitled to, is to stand in the shoes of the insured.

Contribution

Where the assured is over-insured by double insurance, each insurer is bound, as between himself and the other insurers, to contribute rateably to the loss in proportion to the amount for which he is liable under his contract. If any insurer pays more than his proportion of the loss, he is entitled to maintain a suit for contribution against the other insurers, and is entitled to the like remedies as a surety who has paid more than his proportion of the debt. (S.81).

Under-insurance

Where the assured is insured for an amount less than the insurable value, or, in the case of a valued policy, for an amount less than the policy valuation, he is deemed to be his own insurer in respect of the uninsured balance (S.81).

“Causa proxima” or the Proximate Cause

There is a wellknown maxim of marine insurance which runs as follows: ‘*Causa proxima non remota spectatur*’, which means that in deciding whether the loss has arisen through any of the risks insured against, *the proximate or the nearest cause ought to be considered*. It often happens that a succession of causes have operated to bring about a particular damage and the difficulty arises when a number of these causes are not insured against, whereas the others are. In such cases the rule is to see what the proximate or the nearest cause of damage is, and if that is insured against, the underwriter must pay. To take an illustration, in one case the goods were insured against damage by sea-water. Some rats on board bored a hole in a zinc pipe in the bath which caused sea-water to pour out and damage the goods. The underwriters contended that as they had not insured

against the damage by rats, they were not bound to pay. It was, however, decided that the proximate cause of damage being sea-water the insured was entitled to damages, the rats being a remote cause. It may be added that *the same maxim applies in the case of fire insurance.*

Our Act specifically provides in this behalf that unless the policy otherwise provides, the insurer is liable for any loss proximately caused by a peril insured against, but is not liable for any loss which is not proximately caused by a peril insured against. It further provides specifically that—

- (a) the insurer is not liable for any loss attributable to the wilful conduct of the assured, but, unless the policy otherwise provides, he is liable for any loss proximately caused by peril insured against, even though the loss would not have happened but for the misconduct or negligence of the master or crew;
- (b) unless the policy otherwise provides, the insurer on ship or goods is not liable for any loss proximately caused by delay, although the delay be caused by a peril insured against; and
- (c) unless the policy otherwise provides, the insurer is not liable for ordinary wear and tear, ordinary leakage and breakage, inherent vice or nature of the subject matter insured, or for any loss proximately caused by rats or vermin, or for any injury to machinery not proximately caused by maritime perils (S.55).

Insurable Freight

Freight is only earned by the shipowner when the ship reaches its destination safely and the goods are ready for delivery. This rule of law may be modified by an agreement to the contrary between the parties. Generally, in case of a charter-party, where the whole or a large portion of the ship is chartered or hired, a part of the freight is paid in advance and the other part is agreed to be paid on completion of the contract. Here the ship-owner can insure that part of the freight which he is likely to lose in case the ship is destroyed through some accident or does not reach its destination safe. In Insurance on freight, whether paid in advance or otherwise the insurable value is the gross amount of the freight at the risk of the assured, plus the charges of insurance [S.18(2)].

Assignment of Policy of Marine Insurance

An assignment of a policy of marine insurance may be made *either by a writing endorsed on the policy or by merely delivering the policy with the intention to assign.* No particular form for assignment

by endorsement is necessary. When the goods are shipped to countries over the sea and policies are taken out, these policies are generally assigned by the original insured in favour of the person to whom he sells the goods or to the agent to whom the goods are shipped. *The only conditions necessary* are that (1) at the time of assignment the assignor had an insurable interest in the subject-matter insured, and (2) that the risk was at the time a continuing risk. If it turns out that the assignment was made after the subject-matter insured was lost or damaged, it means that the assignor has transferred his own right as to the damage to the assignee. Of course, if there is a clause in the marine insurance policy expressly prohibiting assignment, it cannot be assigned. (S. 52 & 53).

Lloyd's Register of British & Foreign Shipping

This book is published by Lloyd's every year, and shows all particulars as to ships of one hundred tonnage or over which are registered in the United Kingdom, and also all foreign ships which have been specially registered at Lloyd's. This register is issued by a special society called the "Society of Lloyd's Register", the general committee of which is composed of 72 members selected from various classes such as underwriters, ship-owners, ship-builders, merchants from London, Liverpool, etc. The committee will not give its classification to any ship which has not been built according to its own regulations. This register is particularly referred to by the members of Lloyd's while underwriting risks on the ships concerned, as it furnishes detailed information as to the way the ship was built, its tonnage, its proprietor and its condition at the last survey.

Average & Its Computation in Marine Insurance & Shipping

The word *average* as used in shipping parlance means damage, loss or charges or some burden on property carried by sea. This risk is insured against in one form or other by policies of marine insurance both by Lloyd's as well as by insurance companies. Average is divided into two clauses viz. (1) Particular average and (2) General average.

Arnold defines particular average loss as follows—

"A particular average loss is a loss arising from damage accidentally and proximately caused, by the perils insured against, to some particular interest, as the ship alone or the cargo alone."

It would thus be seen that the particular average loss is a loss sustained through the perils insured against, not for the general

safety of the ship, but through a mere accident, which would have to be borne by the owner of the goods if they were not insured against. *The basis on which the loss would be calculated is arrived at by taking into consideration the value of the goods, the actual damage caused, and the actual amount for which these goods were insured. In other words, if the goods were fully insured, the actual value of the goods would be the basis of the particular average claim. The value of the goods is to be either the buying cost, to which all the expenses of putting them on board are added, or as in the case of the valued policy, the actual value agreed upon by the parties. The fluctuations of the market value will not, therefore, affect the amount of damages payable in case of particular average.*

General Average

The general average loss stands on quite a different footing from the particular average. In case of general average, the loss arises from a *voluntary sacrifice* by the captain of a part of the cargo, or some part of the furniture of the ship itself, or some extraordinary expenditure incurred by way of repairs, etc. *to enable the ship to proceed safely with her journey.* If for example, the ship on its voyage meets with a heavy storm and is drifting towards rocks or is leaking, and the captain thinks, after due deliberation that a part of the cargo must be sacrificed by being thrown overboard, that the mast and the ship's cable ought to be cut and thrown overboard and that the ship's cable ought to be touched to effect urgent repairs, consequent to the damage suffered by his ship, or where assistance of some other ship is taken to tow it to the port of safety, to the owner of which salvage has to be paid, all these losses and the extraordinary expenses voluntarily incurred would make up the total of the general average loss. Now, as this general average loss is voluntarily incurred in order to save the ship and the balance of the cargo, *all the persons interested in this voyage must each contribute towards this loss rateably.* If, for example, a ship has on board the goods of *A, B, C* and *D* and the captain has to sacrifice all the goods of *A* and half of those of *B* and has also to break and throw overboard the mast, it would be inequitable to allow *C* and *D*, to receive their goods without contribution. The loss incurred in this case by *A* and *B*, as well as by the ship-owner, was for the general safety, and therefore all the parties interested, *viz. A, B, C* and *D* and the shipowner, respectively, should bear their relative proportion of the loss.

The peculiarity of this general average loss is, that it is a voluntary sacrifice. If, for example, the mast was not particularly thrown

overboard but was washed off by the storm it would be a particular average, and the loss would fall on the shipowner to whom it belonged. Another peculiarity is, that it is a *sacrifice for the general safety*. As in one case, where a mob boarded a ship laden with corn and wanted to purchase the corn at a certain low price, refusing to return till that was done, it was decided that the loss was not a general average loss because neither the rest of the cargo nor the ship was in danger as the mob wanted only the corn.

Where the goods are insured and the insurance covers this general average loss, the underwriter indemnifies the insured for this loss, *i.e.*, pays him the general average contribution which the cargo-owner has to pay on account of the general average loss.

It should be noticed here that the *incident of general average gives rise to two facts, viz.* (1) the loss by way of general average is incurred through the voluntary sacrifice of the goods or ship or part of it; and (2) the general average contribution is paid by the persons interested in the venture for whom the general average loss was incurred. One learned judge put down general average loss as "a loss arising out of extraordinary sacrifice made; or extraordinary expenses *incurred*, for the preservation of ship and cargo". It should also be noted that what is aimed at is, the *sacrifice should be voluntary i.e.*, through an act of men and not through accident; that it should have been *incurred for general safety*, and that if it was not for general safety, or that the general safety was not imperilled, there would be no case for general average contribution. Besides that, it has been laid down that *the sacrifice must have been incurred under circumstances of real pressure and peril*. It is also laid down that the general average expenditure, or sacrifice, ought to be of an *extraordinary nature* which means that, it must not be of the nature which is usual in connection with an ordinary voyage, but *something which the shipowner is not bound to do*; and in one case, where the engine, of a steamship were damaged through being worked ahead and astern in order to get a ship off a bank where it had struck, it was considered an extraordinary loss.

York-Antwerp Rules

As General Average causes many difficulties particularly where adjustments have to be made in foreign courts, an international code has been compiled known as the *York-Antwerp Rules* to facilitate matters. This code admits as general average certain losses, *e.g.*, masts, sails or rigging cut away for the common safety during a

storm; loss of cargo or freight through jettison; damage done to cargo by water used to extinguish other cargo on fire, etc.

In 1864 the Association for the Reform and Codification of the Law of Nations held a meeting at York, England, and another meeting at Antwerp in 1877, when a code of rules as mentioned above was adopted which is known as the "York-Antwerp Rules". In 1890, the Association met again in Liverpool and revised this code. The rules were further revised in 1924. This was the origin of the "York Antwerp Rules" and insurance policies can provide that General Average would be adjusted in accordance with these rules. These rules deal only with certain specific matters relating to general average, and further provide that in case of matters not included in the rules they should be dealt with according to the law and practice of destination.

Policy Proof of Interest or P.P.I. Policy

The contract of insurance is said to be a contract of indemnity, and thus all that the insured can claim is to be indemnified for the actual loss suffered. In other words, he cannot, by insuring property which does not belong to him, or in which he has no interest either as a money-lender or mortgagee, or in any other capacity, or where the destruction or damage to the property does not entail a pecuniary loss, claim to recover the amount covered by the policy; and the policy in such a case is void in law and is known as a wager policy. This is because here the insured is taking out a policy with a view to bet or gamble on the chances of the goods or the ship that he has insured being damaged or destroyed, and the law sternly discourages such transactions. On Lloyd's, however, policies known as "P.P.I." or "Policies proof of interest" or "Honour Policies" or "Wager" or "Gambling" policies are taken out, where the underwriter guarantees that even if the insured may not have any insurable interest in the subject-matter insured, the policy shall be payable in case of loss or damage to the subject-matter insured. This of course does not make the policy enforceable at law though members of Lloyd's may be relied on to carry out their engagements to the letter.

Our Act expressly provides that a contract of marine insurance will be deemed to be by way of wagering and void where the policy is made "interest or no interest", or "without further proof of interest than the policy itself", or "without benefit of salvage to the insurer", or subject to any other like term [S. 6(2) (b)].

SUMMARY

Definition: Marine insurance is an agreement whereby the insurer agrees to indemnify the insured against marine losses.

Essentials of Marine Insurance

- (1) Contract of indemnity.
- (2) Insurable interest to exist at time of loss.
- (3) Utmost good faith or *uberrima fides*.
- (4) Subject to principles of subrogation and contribution.

Who has Insurable Interest

- (1) Ship-owner
- (2) Cargo owner
- (3) A creditor who has advanced money on a ship or cargo to the extent of his interest in such ship or cargo
- (4) Mortgagor
- (5) Mortgagee
- (6) Master and crew in respect of their wages
- (7) Bottomry bond holder
- (8) Persons who pay advance freight if freight is recoverable on loss
- (9) Shippers and their agents
- (10) Persons with defeasible or contingent interest such as the buyer though the goods may be at seller's risk and though he may have the right to reject the goods
- (11) Trustee
- (12) Bailee
- (13) Insurer—he can reinsure
- (14) Assignee of a bill of lading

Types of Marine Policies

- (1) Valued policy
- (2) Open or unvalued policy
- (3) Time policy
- (4) Floating policy
- (5) Voyage policy
- (6) Mixed policy
- (7) Wager policy or PPI policy

Warranty: In marine insurance a warranty is an essential term of the contract. If such a term is broken the whole policy becomes void and inoperative.

Warranties may be –

- (1) express or
- (2) implied

- (1) Express warranties are those terms which are written on the policy
- (2) Implied warranties are those terms which are implied in every contract of marine insurance unless they are expressly excluded,

Implied Warranties

- (1) Seaworthiness
- (2) Non-deviation
- (3) Legality of voyage

Important Clauses in Marine Policy

- (1) Valuation clause
- (2) Sue and Labour clause
- (3) Waiver clause
- (4) Touch and stay clause
- (5) Warehouse to warehouse clause
- (6) Premium clause
- (7) Memorandum clause

Marine Losses

- (1) Total loss
 - [a] Actual total loss
 - [b] Constructive total loss
- (2) Partial loss
 - [a] Particular average
 - [b] General average

Difference between:

Actual Total Loss	Constructive Total Loss
1. Physical impossibility	1. Commercial impracticability
2. Notice of abandonment not necessary	2. Notice of abandonment necessary

Average: Average in marine insurance means loss or damage to a ship or cargo or the expense resulting from such loss or damage.

General average

- (1) Extraordinary loss
- (2) Voluntarily and reasonably incurred
- (3) By captain or any other officer of the ship

- (4) To protect or preserve the ship or passengers and crew or cargo in general, *i.e.*, to avoid a common danger.

Particular Average

- (1) Any partial loss or damage
- (2) To only a part of a particular subject matter, *e.g.*, the ship or cargo
- (3) Resulting from an accident or normal perils of the sea

TYPICAL QUESTIONS

1. What are the salient features of Marine Insurance?
2. Write notes on:
 - (a) Bottomry and respondentia bonds
 - (b) Inchmaree clause
 - (c) Maritime lien
3. "Average in a fire policy is quite different from average in a marine policy." Explain and illustrate.
4. Discuss the doctrine of subrogation in relation to fire and marine insurance.
5. Define Marine Insurance. Explain the maxim "Marine Insurance contract is a contract of indemnity".
6. What does the term "insurable interest" mean in the case of marine insurance policy? Besides the owners of the ship and the owner of the cargo, who else can have insurable interest sufficient to take out such a policy?
7. How is the contract of Marine Insurance effected on the Lloyds? What is (a) a ship, and (b) a cover note? Have they any legal force?
8. (a) Explain with reference to Fire and Marine Insurance: (1) Insurable Interest, (2) Subrogation. Give instances.
(b) *A* and *B* are brother and sister. Can *A* be said to have insurable interest in *B* and vice versa? Give reasons.
(c) Distinguish between Re-insurance and Double insurance.
9. What is the difference between a Time Policy and a Voyage Policy in Marine Insurance? Is there any implied warranty in either policy as to the fitness of the vessel insured? If so, what is the nature and the extent of the warranty?
10. What is the meaning of "deviation" in marine insurance? When is it excused?
11. Explain carefully the words "perils of the sea". S.S. Airdale sailed from Amsterdam for Bombay. Owing to the negligence of the ship's crew, she came into collision with another ship and a portion of her cargo was lost. State whether the loss suffered by the owner of the Cargo would fall within the meaning of loss arising from perils of the sea in a bill of lading.

12. What principle does the "Sue and Labour" clause in a Marine Insurance Policy lay down? Discuss fully.

13. Explain with reference to Marine Insurance contract: (a) F. P. A. clause in the policy, (b) Difference between Re-insurance and Double insurance, and (c) Average.

14. Distinguish Total from Partial loss. What are the liabilities of Underwriters (1) where a ship is totally lost, (2) Where it is only partially lost? Explain what is meant by "Constructive Total Loss".

15. Explain. (a) Bottomry Bond, (b) Salvage, (c) Particular Average.

16. Explain "Average-Statement", "Jettison", "Barratry", "Cover Note", "Loss by fire".

17. (a) Explain an 'open policy' giving one illustration.

(b) Explain 'Abandonment' and "Subrogation" and their relation.

18. Two ships *A* and *B* belonging to different owners came into collision which was due to the negligence of those in charge of *B*. The owner of *A* has insured her for £ 75,000, and received £ 10,000, as damages from the owner of *B*. How much can he recover from his insurer?

Suppose in the above case both vessels had belonged to the same owner, how much could he have recovered from the insurer of vessel *A* in respect of the said insurance of £ 75,000?

19. Explain the maxim—*Causa proxima non remota spectatur*.

20. Write short notes on any two of the following:—

(a) Jettison

(b) Charter Party.

21. (a) How far is a bill of lading a negotiable instrument?

(b) When is devlation excused?

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Chapter 21

COMMON CARRIERS AND CARRIAGE OF GOODS BY LAND, AIR & SEA

CARRIERS INCLUDE those who carry goods and passengers by land, air and sea. Generally speaking the duties and liabilities of carriers in India are governed by the *Common law* of England, except where modified by the *Carriers Act of 1865 and subsequent amendments to that Act*. In case of railways the *Railways Act of 1890 as amended in 1961* governs the position. In the case of carriage by air the *Carriage by Air Act of 1934* deals with that question. There is also the *Marine Insurance Act, 1963*, dealt with in the previous chapter.

Carriers are divided into two main headings, i.e. (1) *Private Carriers* and (2) *Common Carriers*.

Private Carriers

Private Carriers are those who *occasionally* carry goods for others and that too *under special agreement*, which may vary from customer to customer whereas Common Carriers are prepared to carry goods or passengers for all who choose to employ them and receive as their reward or hire a sum of money.

Common Carriers

The Carriers Act of 1865 defines a “common carrier” as “a person other than Government, engaged in the business of transporting for hire, property from place to place, by land or inland navigation, for all persons indiscriminately”.

A “person” in the above definition includes any association or body of persons, whether incorporated or not. Thus the term “Common Carrier” does not include a carrier of passengers, Government and carries such as railways under the control of Government, carriers of persons and carriers by sea.

Common Carriers thus must take goods offered to them for carriage and cannot refuse to do so unless there is a lawful excuse for refusing them. A common carrier holds out, expressly or by conduct that he is prepared to carry for *hire* provided.

- (1) he has room for the goods.
- (2) the goods are of the type he usually professes to carry and
- (3) the destination is also along his usual route. Thus a Common Carrier cannot pick and choose the persons for whom he will act as a carrier for goods.

The following have been held to be Common Carriers:—

- (1) Proprietors of stage-wagons, omnibuses and motor lorries which carry goods for hire.
- (2) Owners and masters of ships engaged generally in the transportation of goods for hire.
- (3) Lightermen, bargemen, hoymen and ferrymen doing the same kind of work and truckmen, cartmen, porters who undertake to carry goods for hire from one town to another or from one part of the town to another.
- (4) Railway companies as to goods which they profess to carry or actually carry for passengers generally, including their personal luggage.

The following have been held not to be Common Carriers—

- (1) A carrier of passengers only.
- (2) A towncarman not plying between certain termini, but undertaking casual jobs.
- (3) A wharfinger who only carries the goods of his customer by lighter from the ship to the warehouse.
- (4) Furniture removers.

Liabilities and Duties of Common Carriers

Whereas Private Carriers are liable for any loss or destruction of the goods through their negligence, the *responsibility of Common carriers is greater* as the law implies that they, so to say, guarantee or ensure the safety of the goods they carry, unless the loss was occasioned by what is called an "Act of God" or by "the King's enemies", or loss arising through the inherent or latent defects in the goods themselves, which would include deterioration in the case of perishable goods, as well as loss due to indifferent packing or owner's neglect.

It has been decided by the Privy Council¹ that the liability of common carriers is governed by the principles of the Common Law of England. Therefore the liability of a Common Carrier is governed by (1) The Common Law of England as modified by (2) the Carriers Act of 1865.

The liability of a Common Carrier begins as soon as he expressly or by implication accepts goods for carriage. These goods he is bound to carry safely and deliver in the same safe condition within a reasonable time at their destination. If perishable goods get spoiled on the way and the carrier believes that he will not be able to deliver them in good condition, he has the power to sell them. This sale is known as "Sale by Necessity", and before the sale is made as far as possible the carrier is expected to obtain instructions from the owner of the goods. The same rule applies to Common Carriers by Sea as we shall see later. We have also seen that he must deliver the goods within a reasonable time and if there is an unreasonable delay he may have to pay damages. Here, however, the carrier is within his rights to make an agreement with the owner of the goods as to time for delivery and may even exclude his liability for damage done by delay by a special agreement. The carrier is also expected to take the customary route which may not necessarily be the shortest route. The "warranty of non-deviation" which applies to shipping also applies to Common carriers by land and it is expected that there shall not be any unnecessary delay by a Common Carrier by land or sea as that deviation may deprive the carrier of the exemption from liability he has obtained through a special agreement. After the goods have been brought to their destination but before they are taken delivery of by the owner or the party to whom they are sent, the carrier has to warehouse them, the carrier's responsibility as a

¹ *Irrawadi Flotilla Co. v. Bhagwandas* 18 I.A. 121.

carrier ceases and the only responsibility which now continues is that of a common bailee under the Indian Contract Act.

The Indian Carriers Act, 1865

The Indian Carriers Act referred to above was passed to relieve Common Carriers in India from some of the extraordinary liabilities which the Common law of England imposed on them, particularly in the case of goods delivered to them which were of exceptional value or of a perishable nature which have been declared to be valuable or perishable. Thus it is laid down by the Act of 1865 that where a consignment exceeding Rs 100 in value and of the description mentioned in the Schedule annexed to the Act, is offered for carriage without declaration of its value, the carrier shall not be liable for loss or damage to such an article. If, however, the value is declared, the carrier is entitled to charge an extra freight or reward, but will be liable for loss or damage. *The Schedule to the Act mentions articles such as gold, silver, precious stones, jewellery, time-pieces, currency notes, Government securities, maps, title-deeds, articles of ivory, ebony, or sandalwood, opium, musical and scientific instruments, glass, china, jade, amber, hemp, rubber, feathers, etc.* The State Government is authorised to add to the list other articles by notification in the Official Gazette. *When the damage occurs* the owner of the goods who has declared the goods and paid extra freight is entitled to recover this extra or additional payment, as well as the damages he has sustained because of the loss of the goods. However, where the value has been declared by the owner his claim cannot exceed that value, whereas the carrier is empowered by the Act to challenge the valuation at the time of loss and insist upon proper proof. Owing to some conflicting decisions of the Bombay and Calcutta High Courts and the judgement of the Judicial Committee of the Privy Council in *Irawaddi Flotilla & Co. v. Bhagwandas*,² the Carriers (Amendment) Act of 1921 was passed in order to amend Section 8 of the Carriers Act of 1865. In the Carriers Act of 1865 under Section 8 it was laid down that in cases of negligence the carrier was liable in any event for any article which was lost or damaged. This section made the law laid down in Section 3 to a great degree nugatory, viz. that scheduled articles of value or those of a perishable nature, if valued at more than Rs 100 must be declared and the extra rate paid. The Amending Act of 1921 removed that position and now the rule is that *whether the loss or damage is due to negligence or not the carrier is not liable, unless the value of the*

² 18 C 829, P.C.

article has been declared in accordance with the requirements of Section 3. The other defect in the Carriers Act of 1865 was remedied by the addition of Section 10 in 1899, providing that the claimant for damage or loss must notify his claim to the carrier within six months of the date when the claimant first knew of the injury. The carrier is also liable under the Act of 1865 for loss or damage due to any criminal act of the carrier himself, his servant or agent and for unlawful acts or misfeasance, viz., converting the goods to his own use or knowingly delivering them to a wrong person.

CARRIAGE BY RAILWAY

In England the liability of railways has always been of common carriers as limited by the Carriers Act. In India until the Amending Act of 1961 the liability was that of a bailee under Sections 151, 152 and 161 of the Indian Contract Act. Now, according to the Railways Act, 1890, as amended in 1961, the liability of the Railway Administration as carrier of animals and goods is that of common carriers. This liability can be limited by special contract subject to the provisions of Sections 72 to 78B of the Indian Railways Act, 1890.

The Indian Railways Amendment Act, 1961, which came into force on January 1, 1961, recast Sections 72 to 78 to enlarge their responsibilities from that of simple bailees to those of common carriers. Under the amended Section 73, the Railway Administration is responsible for the loss, destruction, damage, deterioration or non-delivery in transit of animals or goods delivered to it to be carried by railway arising from any cause subject to certain exceptions. The exceptions are—

- (i) act of God,
- (ii) act of War,
- (iii) act of public enemies,
- (iv) arrest, restraint or seizure under legal process,
- (v) orders by or on behalf of the Central or State Government,
- (vi) acts or omission or negligence of the consignor or the consignee or their agent,
- (vii) natural deterioration due to inherent vice,
- (viii) latent defects, and
- (ix) fire or explosion.

The effect of this amendment is to make the liability of the Railway Administration the same as that of a common carrier in England *i.e.*, as an insurer of goods.

Risk Notes

Section 72 of the Act requires the executing of a Note called the *Forwarding Note* in the prescribed form by any person delivering any animal or goods to be carried by Railway—

- (a) if the animal or goods are to be carried by a train intended solely for the carriage of goods, or
- (b) if the goods are to be carried by any of the trains consisting of articles of any of the following category:
 - (1) articles carried at owner's risk rates;
 - (2) articles of a perishable nature;
 - (3) articles mentioned in the Second Schedule which are articles of a valuable nature, such as gold, silver, precious stones, Government securities, Government stamps, bills of exchange, work of art, etc;
 - (4) articles in a defective condition or defectively packed; and
 - (5) explosives and other dangerous goods.

In such Note the sender or agent must give particulars in respect of the animals or goods so delivered as may be required.

Owner's Risk Rate & Railway Risk Rate

When any animal or goods are tendered to the Railway Administration for carriage and the Railway Administration provides for the carriage of these goods either at ordinary tariff rate (called the "*Railway Risk Rates*") or in the alternative at a special rate (called the *Owner's Risk Rate*") the animal or goods are deemed to have been tendered to be carried at owner's risk rate unless the sender or his agent *elects in writing* to pay the Railway Risk Rate. In such a case the Railway Administration has to issue a Certificate to the consignor to that effect.

Railway's Liability as a Carrier

The following is a brief description of the liability of a Railway Administration during transit under the Railway Act as amended in 1961. If the goods, etc. are carried at *Owner's Risk Rates* the liability is that of bailee (*i.e.*, the same as under the Railways Act before it was amended). If carried at *Railway Risk Rate* (*i.e.*, at a higher rate), the liability is the same as that of a common carrier (*i.e.*, the liability is higher). The liability of the Railway Administration after termination of transit and during 30 days after the termination of the transit is as follows:—

- (a) If carried at Owner's Risk Rate, the liability is the same i.e., that of a bailee under Sections 151, 152 & 161 of the Contract Act.
- (b) If carried at Railway Risk Rate, the liability is reduced to that of a bailee.

Regarding articles of a special value like gold, silver etc. (mentioned in the Second Schedule to the Act), the Railway Administration is not liable in any event after the termination of the transit. Thirty days after termination of transit the railway is *not* liable at all.

Notice of Claim under Section 78 B

A person will not be entitled to claim compensation for the loss, destruction, damage or deterioration or non-delivery of animals or goods unless his claim for compensation has been preferred in writing-

- (a) to the Railway Administration to whom the goods were delivered for carriage, or
- (b) to the Railway Administration on whose Railway the destination station lies or the loss, destruction, damage or deterioration occurs.

Such notice must be given within six months from the date of the delivery of the animals or goods for carriage by Railway. This notice may be given to the Chief Commercial Superintendent or the Manager of the Railway.

However, such notice is to be construed liberally. Thus any information demanded or enquiry made in writing or any complaint made within a period of six months will be sufficient compliance with the provision regarding notice, under the said Section 78B.

Section 80 of the Code of Civil Procedure

No suit shall be instituted against the Government as owning the railways in India until expiration of two months next after notice in writing has been delivered to or left at the office of the General Manager of the Railway concerned. The notice must set out the (a) the cause of action, (b) the name, description and place of residence of the plaintiff, and (c) the relief he claims. The Plaint must contain a statement that such notice has been left or delivered as stated above.

CARRIAGE BY AIR

The law applicable to India in the case of international carriage by air of passengers, their luggage and goods, is the Provisions of the Warsaw Convention of 1929 dealing with the rights and liabilities of carriers and passengers etc. irrespective of nationality.

The carriage by Air Act, 1972, was passed to bring the amended rules into force. Sections 3 and 4 of the Act of 1972 make the rules contained in the First and Second Schedules to the Warsaw Convention applicable in India. These rules relate to carriage of passengers and goods by air across *international* boundaries. Although the Act does not apply to internal carriage by air, the Government has power to make the provisions of the Act applicable to internal carriage by a notification subject to such exceptions, adaptations and modifications as the Government may deem fit.

As far as *internal carriage by air* is concerned, so far the common law of England applies and the *liability of an internal carrier* is that of a *common carrier* and not of a bailee. He may, however, limit his liability for loss due to his own negligence or misconduct or that of his servant, by a special agreement (*Indian Airlines Corporation v. Madhur Chowdhri*, A.I.R. (1965) Cal. 272.)

Documents of Carriage

The documents of carriage used in a contract of carriage by air under the Carriage by Air Act, 1972 are:

- (1) The passenger ticket
- (2) The baggage check or
- (3) Airway bill

Carriage of Passengers by Air

In the case of a passenger carried by air the carrier has to deliver a *passenger ticket* to him. Such a ticket is *prima facie* evidence of the conclusion and conditions of the contract of carriage.

The following particulars are required to be stated in the passenger ticket:

1. An indication of the places of departure and destination,
2. if the places of departure and destination are within the territory of a High Contracting Party (*i.e.* a contracting party to the amended convention) and one or more agreed

stopping places are within the territory of another State, an indication of at least one such stopping place,

3. a notice that if the passenger's journey involves an ultimate destination or stop in a country other than the country of departure, the amended Convention may be applicable and that the amended Convention governs and in most cases limits the liability of carriers for death or personal injury and in respect of loss of, or damage to baggage [Rule 3(1)]

In the case of registered baggage, a *baggage check* must be delivered which unless it is combined with or incorporated in a passenger ticket which complies with Rule 3 (1) must contain the following particulars.

1. An indication of the places of departure and destination,
2. if the places of departure and destination are within the territory of a single High Contracting Party, and one or more agreed stopping places are within the territory of another State, an indication of at least one such stopping place,
3. a notice that if the carriage involves an ultimate destination or stop in a country other than the country of departure, the amended Convention may be applicable and that the amended Convention governs and in most cases limits the liability of carriers in respect of loss of or damage to, baggage (Rule 4 (1))

As in the case of the passenger ticket, the baggage ticket is also *prima facie* evidence of the registration of the baggage and of the conditions of the contract of carriage.

An *air way bill*, (known as the "air consignment note" in the original Warsaw Convention) is a document which every carrier of cargo has the right to require the consignor to make out and deliver to him, and the consignor has the right to require the carrier to accept the document. The air waybill is to be made in three original parts, one marked "for the carrier" and signed by the consignor. The second marked "for the consignee" and signed by the consignor and by the carrier and the second bill is to accompany the cargo. The third part is to be signed by the carrier and handed over to the consignor after the cargo has been accepted [Rule 6 (2)].

The particulars to be stated in the air waybill are the same as those required to be stated in the passenger ticket and baggage check (Rule 8).

The air waybill is *prima facie* evidence of the conclusion of the contract, the receipt of the cargo and the conditions of carriage (Rule 11).

Liability of Carrier

The liability of the carrier by air is provided in Rules 17 to 25. The liability is for—

1. damage sustained in the event of death or wounding of a passenger or any other bodily injury suffered by a passenger, if the accident which caused the damage took place on board the aircraft or in the course of any of the operations of embarking or disembarking;
2. damage sustained in the event of destruction or loss of, or damage to, any registered baggage or any cargo, if the events which caused the damage so sustained took place during the carriage by air. Here the term “carriage by air” means the period during which the baggage or cargo is in charge of the carrier, whether in an aerodrome or on board an aircraft, or in the case of a landing outside an aerodrome, in any place whatsoever;
3. delay in the carriage of baggage, cargo or passengers.

Limits to Carrier's Liability

The limits to a carrier's liability are laid down in Rule 22. They are:—

1. In the case of passengers 2,50,000 francs per passenger unless he contracts for a higher amount [Rule 22(1)] In the case of countries which have not signed the Hague Protocol, the limit is 1,25,000 francs per passenger unless there is a contract for a higher amount. In the case of domestic or *internal carriage*, the liability of the carrier for each passenger is Rs 100,000 but if the passenger is below 12 years of age, the liability of the carrier is reduced to Rs 50,000.
2. *In the case of registered baggage or cargo*, 250 francs per kilogram unless the consignor declares the value of the package at the place and time of delivery and also pays or agrees to pay a sum not exceeding the declared sum unless that sum is proved by the carrier to be of higher value than the real or actual value at the time and place of delivery [Rule 22 (2)].

3. *In the case of goods in charge of the passenger, 5,000 francs per passenger [Rule 22 (3)].*

It should be noted that a carrier cannot reduce his liability but may undertake a higher liability by a special agreement (Rule 23).

The carrier is not liable in case of injury to passengers if he proves,

- (a) that he and his agents had taken all necessary measures to avoid the damage or that it was impossible for him or his agents to take such measures (Rule 21) or
- (b) that the passenger was guilty of contributory negligence and the Court had wholly exonerated the carrier from liability (Rule 21).

SHIPPING AND CARRIAGE BY SEA

A contract for the carriage of goods by sea is to be found either in the form of a charter-party, or as in the case of a general ship, it is embodied in a bill of lading. "Ship" includes every description of vessel used in navigation not propelled by oars, and "vessel" includes any ship or boat or any other description of a vessel used in navigation.

These contracts for the carriage of goods over the sea are known as "*contracts of offreightment*". The consideration paid for carrying of these goods is known as the "*freight*".

Carriers by sea for hire are common carriers and are governed by the common law of England but such carriers are not common carriers within the meaning of the Carriers Act of 1865, and are not entitled to the benefits of the Act. The Carriage of Goods by the Sea Act of 1925 adopted some of the rules of the Brussels Convention on Maritime Law. That Act declares void any term in a contract of carriage whereby the carrier or the ship is exempted from liability for loss or damage to goods caused by negligence or by any default or failure to discharge duties under the Act. That Act also provides to the effect that a carrier or ship shall not be responsible for loss or damage to goods exceeding Rs 100 per package in value unless the nature and value of the goods have been declared by the shipper before shipment and are inserted in the bill of lading.

Chartered or General Ship

When a merchant wishes to send goods over the sea to some other part of the world, he hires a whole steamer or part of it, or he

ships his goods on what is known as a *general ship* i.e., a ship belonging to another person or company, which declares its intention to go on a particular voyage of its own accord and offers to carry goods belonging to others to any of the places at which the steamer is to call. In either of these cases the *consideration paid to the owner of the ship* for this service or hire is known as *freight*.

Shipping Agreements of Hire

When the whole of a ship, or a large portion of it, is hired for a voyage, or for a period, a formal agreement is drawn out embracing clauses stating the various conditions of the contract. This agreement is called the *charter-party*. The form of the charter-party depends on the agreement between the parties to it, the custom of the particular ports involved, and the nature of the adventure. The *charter-party* may operate as a *demise*, in which case the ship entirely passes under the control of the hirer who becomes the virtual owner for the time being, and the officers and crew in such cases take their orders from him (the hirer), or, as is more usually the case, it may form an agreement under which the use of the ship is temporarily given over for a particular purpose, both the ownership and the control of the officers and crew remaining with the ship-owners. Much, of course, would depend on the nature of the agreement contemplated by the charter-party.

When the goods are delivered on board, a document called the *bill of lading* signed by the owner of the ship is given to the shipper, in which the owner acknowledges receipt of these goods. *Where a charter-party is drawn out the bill of lading forms a simple acknowledgment of the receipt of the goods* on board and refers to the conditions in the charter-party under which the goods are received. In a general ship, there is no charter-party, as here the voyage is undertaken on the owner's account, a large number of merchants shipping their goods to be carried to the ports under which the steamer is to call in the course of its voyage. Thus *in a general ship, the ship-owner acts as a common carrier* carrying goods, for all who desire to send them, to the ports declared by him and *there the bill of lading, besides forming an acknowledgment of the safe receipt of the goods, contains various conditions and stipulations making up the contract*. The practice in this case is that the shipper, on delivering his goods on board, receives from the captain a provisional receipt for the goods known as the "*Mate's Receipt*", which is exchanged by him for the regular bill of lading at the office of the shipping company concerned.

It should be noted that *in both cases viz.*, where the charter-party is made out and where it is not, *the bill of lading is indispensable.* The only *difference* is that, in the first case, where the charter party is made out, the bill of lading is a simple acknowledgment of the goods received on board, whereas, in contract of carriage are printed on the instrument. *These two documents make up the contract of affreightment.*

Charter-party

The term charter-party is supposed to be a corruption of the Latin word *Charta Partita*. It is *an agreement* by which a ship-owner agrees to hold his *ship or part of it at the disposal of the shipper* so that the shipper's goods may be conveyed to the agreed port of destination, the *money consideration* paid by the shipper to the ship-owner for this, being called the *freight*.

The *charter-party has to be stamped*. The actual form or wording of a charter party is not settled by law, and the forms of charter-parties differ in the matter of detail according to the custom of the ports where they are made out and also according to the nature of the voyage or enterprise, but the main and important clauses of these contracts of affreightment are now almost uniform in all charter-parties by the custom of the shipping trade. We shall, therefore, proceed to examine the peculiarities of the *most important clauses of the charter-party*. These clauses generally relate to the following:— (1) The parties, (2) the term of the voyage (3) condition that the ship is seaworthy, (4) prosecution of the voyage, (5) master to obey charterer, (6) time lost by breakdown, (7) freight payment, (8) cargo, (9) penalty, (10) excepted perils, (11) negligence, and (12) lay days.

(1) The Parties & (2) the Term: The first clause of the charter-parties deals with the name and description of the parties and the name and the description of the ship. The next clause deals with the terms for which the ship is hired when it is hired for a fixed time; or the voyage, in case it is engaged for a particular voyage.

(3) Condition of the Ship or "Seaworthiness". This clause in a charter-party, usually runs as follows—

"That at the date of the commencement of the voyage, the ship shall be *tight, staunch and strong*, and in every way fitted for the voyage, and shall be manned with a full complement of officers and crew, and ready to take cargo".

Under our Indian Mercantile Shipping Act, Section 4, *unseaworthiness is defined as—*

A ship is *unseaworthy* within the meaning of this charter when the material of which she is made, her construction, the qualifications of the master, the number and description of the crew, the weight, description and storage of cargo, the tackle, sails, rigging, stores, ballast and other equipment generally are not such as to render her in every respect fit for the proposed voyage for service. Provisions in this behalf of the Marine Insurance Act 1963, have already been mentioned in the previous chapter.

Under this clause the ship-owner expressly guarantees to the hirer that this ship would be "*seaworthy*" *at the commencement* of the voyage. Seaworthy, in simple language, means *reasonably fit to undertake the service for which she is meant and to face the perils and accidents of a voyage which she would have to face on the voyage in contemplation*. In other words, she must not be in leaky state or with sails in a rotten condition, or with an insufficient supply of coal to last on the voyage, etc. She must also be under the command of a qualified officer and must carry an adequate number of sailors or seamen. A ship's seaworthiness may also be affected by the bad method employed in storing cargo, which might lay it open to the risk of capsizing. This seaworthiness must not only exist at the time the ship sets out on its voyage, but *if that voyage be divided in stages at the commencement of every stage the ship must be in a seaworthy condition*, e.g., if a ship is leaving Bombay for London, it must not only be seaworthy at the time she sails from Bombay, but when she reaches Aden, and after touching the port wishes to start for the next stage, say, Port Said, she must also be in a seaworthy condition at the moment of time she leaves Aden, and so on. When, therefore, the hirer goes to insure his cargo with an insurance company or underwriter he is protected by this guarantee because, as explained in the Chapter on Marine Insurance, one of the implied warranties in marine insurance is that the ship on which goods are carried, will be or was seaworthy at the commencement of the voyage. *This warranty from the shipowner, to provide a seaworthy ship, is absolute, and he must make an honest endeavour to comply with it. A breach of this warranty would lay the ship-owner open to an action for damages suffered through unseaworthiness.*

(4) & (5) **Prosecution of the Voyage:** There is also a clause to be found in charter parties stating that the voyage, shall be prosecuted "*with all convenient speed*", i.e., with all reasonable despatch as soon as the necessary clearance has been obtained, and the clearance itself ought to be obtained without undue delay as per the terms in

the charter-party. It may be mentioned in this connection that before a ship is allowed to start on a voyage, it has to obtain a clearance certificate. This is generally obtained by the ship-owner, unless as per the charter party the charterer has agreed to do so. The master of the ship, therefore, under the usual circumstances, obtain this certificate, which must be obtained without unreasonable delay, otherwise the shipowner would be responsible for loss caused through the delay.

This clause should clearly define the voyage, specifying the port of loading and the port of discharge. The steamer has to take the usual course of navigation followed by other steamers and must not deviate, except in cases where deviation is excused, as indicated in the Chapter on Marine Insurance.

(6) **Master to Obey the Charterer and Delay through Break-down:** The next clause states as to how far the captain has to take his orders from the hirer and the clause as to breakdown generally lays down that in cases where there is delay through the breakdown of machinery or deficiency of crew, or other damage to the ship, for twenty-four hours, the hire would cease till the ship is again put in a fit condition.

(7) **Freight Payment:** *Freight is the consideration agreed to be paid by the cargo-owner to the ship-owner for hiring the ship, or a portion of it, for carrying of the goods between certain ports. A separate clause in the charter-party lays down the agreement with regard to it. This is a very important clause as it lays down when and how to whom the freight is payable. Generally speaking the freight is taken to be due on completion of the voyage when the goods are ready for delivery. If a part of the goods are lost during the voyage, the freight on that part would not be payable. In every charter-party, however special stipulations as to freight are inserted. If the stipulation lays down specifically that the freight is payable in advance, then if the ship commenced its voyage and was lost thereafter no part of the freight paid in advance is returnable. The advance freight falls due at the moment the ship commences its voyage, and if not paid it can be recovered by the shipowner even in case of the loss of the ship. Besides, the freight may be payable per ton, per package, or in a lump sum. If the hirer does not give a full cargo as agreed, he would have to make good the damage known as *dead freight*.*

The gross sum stipulated to be paid for the entire use of the ship for one entire service is referred to as *lump freight*. It is payable if the ship-owner is ready to perform his contract even though no

goods are shipped, or part of the goods shipped is not delivered. In order, however, to entitle the ship-owner to earn lump freight, he must deliver some goods out of those shipped. Thus if the whole cargo is lost no freight will be earned.

If cargo is not delivered and its non-delivery was the result of acts for which the ship-owner is responsible, the person entitled to receive the cargo may recover as part of his damages the freight for that portion of the cargo which is not delivered. This is known as *back freight*.

If the ship-owner has contracted to load a full cargo but only loads and carries part of it, or, if having load a full cargo, he only delivers part of it, he will, unless there is an express agreement for lump freight, be only entitled to *freight pro rata* on the quantity delivered. Similarly, where the ship-owner delivers the goods to the consignee short of the port of destination, he can only claim freight proportionate to the amount of the voyage actually completed. However, in order to justify a claim for *pro rata* freight there must be such a voluntary acceptance of the goods by the owner, at a port short of their final destination, as to raise a fair inference that the further carrying of the goods was intentionally dispensed with by their owner.

An extra percentage is frequently arranged to be paid over and above the agreed freight known as the *hat money* or *primage*. This formerly went to the master as consideration for extra care to be taken on the goods. In strict law, it is the master's remuneration which he can recover from the ship-owner. The practice now is that the ship-owners, at the time of engaging a master's services, take an agreement from him in which the latter agrees to forego his primage in consideration of the payment of a regular salary. In some charter parties it is expressly stipulated that in case of the loss of the ship, only a certain portion of the agreed freight would be payable. This clause would then hold good.

It must also be noted that the ship-owner has a lien in law on the goods he carries for the freight due on them and, therefore, he can refuse to deliver the cargo till the freight due is paid. In a case of advanced freight, however, or in a case of dead freight, or demurrage, there is no lien in law and special clauses are generally inserted in the charter-parties to enable the ship-owner to acquire such a lien. Such a clause is called the "*lien clause*" of the charter-party. In the absence of such a clause it has been held that it is the cargo which is liable to pay the freight by the general law, and therefore the merchants

who have shipped their goods on chartered ships are not responsible for any more freight than that covered by their own goods. In the case of *Paul v. Birch* (1743)¹ Paul hired his ship to one Birch at £ 48 per month. Birch took cargo of different merchants at £ 9 a ton for carriage. Birch then turned bankrupt. Paul sued the merchants to pay him the full hire due. It was decided that he could recover no more than what the merchants had engaged to pay for their respective goods. His Lordship said—

“A person who lets out a ship to hire, ought to take care that the hirer is a substantial man, it is his business to look to this; and if the persons who hire are not competent, the master must suffer for his neglect. Whatever hardship, therefore, there may be on the one hand to the person who lets out to hire, the hardship is much greater on the other side; and what gives additional weight to the merchant's case is the great convenience this gives to trade in general.”

There is no common law lien for freight payable in advance.

(8) & (9) Cargo Etc.: Clauses are also to be found in a charter-party to the effect that the charterer should ship *lawful merchandise*, and mentioning those who are to pay the working expenses of the ship. The usual practice is to actually state the nature of the cargo to be shipped. This may be stated in a general form such as “cotton, seed and wheat”. The cargo has to be as near to the description as the circumstances of each case would permit. Of course, in the case of a general ship such a specific description of the cargo is not possible and the words “lawful merchandise” are generally used. As per Section 32 of the Indian Mercantile Shipping Act—

“No cargo of which more than one-third consists of any kind of grain, corn, rice, paddy, pulse, seed, nuts or nut-kernels (hereinafter called the cargo) shall be carried on board any Indian ship unless the same be contained in bags, sacks, or barrels, or secured from shifting by board or bulkheads or otherwise.”

Any neglect of this condition by an owner or master of a ship is made *penal*. It may, however, be added that in the case of a chartered ship where the clause in the charter-party expressly states the nature of the cargo, no other cargo which does not answer that description can be loaded without the consent of the ship-owner, as the ship-owner is only bound to carry the cargo specified in the charter. The charter-party also states the quantity which the ship-owner undertakes to carry.

A special clause is frequently inserted stating the amount of penalty, if any, for the non-performance of the agreement.

¹ 2 Alk. 221

(10) **Excepted Perils:** All charter-parties contain a clause by which *the ship-owner exempts himself from liability* arising from a particular set of perils, viz:—(1) *Act of God*. This means some unforeseen peril or accident which is not the result of any human agency and which no human agency could have reasonably foreseen or prevented; e. g. ship struck down by lightning, etc. (2) “*King’s enemies, restraint of princes, rulers and people, Enemies*” here mean *foreign* enemies of the king and not traitors. “*Restraint*” here means embargo, blockades, etc., levied by any lawful authority which interrupt the voyage and may include seizure of the ship, or cargo, by our Government, or even by friendly states not at war with us. It may happen that on the outbreak of war between two states friendly to us, an embargo is declared by one or both of them of each other’s ports and it would be useless to send a ship to such a port. (3) *Perils of the sea*. These mean ordinary accidents and dangers of a sea voyage which are not brought about by negligence of the captain, such as collisions, heavy storm bringing seawater in the ship, etc. (4) *Barratry of master and crew, pirates, etc.* In former days when no regular postal or telegraph service existed and when the world was not properly mapped, the master and crew often resorted to frauds of various types such as selling the goods, abandoning the ship and absconding, etc. In fact “*barratry*” means in law all frauds knowingly committed by the captain with the intention of benefitting himself at the expense of his owners, and where the master deliberately violated his duty to his employer. *A mere negligence or inadvertence would not fall under this heading.* Pirates, too, have disappeared nowadays except on the coast of China, but robbery by them on the sea is generally treated in charter-parties as an exempted peril. This term is also held now to include rioters who attack the ship at shore. It may be added here, that *the charterer can and does always protect himself against these risks, by taking out a marine insurance policy with proper stipulations.*

Of course, at *Common law*, the ship-owner is not liable for any loss or damage arising through the act of God, or through any act on the part of the King’s enemies or through any inherent defects in the goods. In spite of this, the charter-party contains stipulations excluding the liability of ship-owners on those grounds. We have also considered at some length the meaning of the expression “*perils of the sea*” in the Chapter on Marine Insurance, and thus need not deal with this point further. The exact wording of the clause as appearing in the charter-parties generally is as follows—

"The act of God, the King's enemies, restraint of princes and rulers, fire and all and every dangers and accidents of the seas, rivers and navigations of what nature and kind soever, throughout the voyage being excepted."

(11) Negligence: This clause provides for loss occasioned through accidents such as collisions, stranding, breakdown in boilers and machinery, even though such accidents are caused through the negligence, default, or error of the captain or officers, or servants of the ship-owners. The ship-owner is specially exempted from liability through the operation of this clause unless it is due to want of due negligence on the part of ship-owner, or the captain, or caused while attempting to render salvage services.

The negligence clause will not exclude the implied condition as to seaworthiness of the steamer at the commencement of the voyage.

(12) Lay Days: Charter-parties generally lay down the number of days allowed for the loading and unloading of cargo. If the word 'days' is mentioned without any qualification, it is doubtful whether working days would be construed to be meant at all harbours. As per the acknowledged custom on the river Thames, "days" have been held to mean "*working days*". In all other cases it would be the safest course to use the expression "*working days*" in the charter-party. If the charter-party is entirely silent on this point, a reasonable time for loading or unloading of the steamer would be taken as implied. What is a reasonable time would depend on the circumstances existing at the time of the performance of the obligation. According to Lord Chief Justice Cockburn—

The question whether the time was reasonable or unreasonable ought to be judged with reference to the means and facilities available at the port, and to the regulations and course of business at the business at the port.⁴

The expression "*custom of the port*" as used in charter-parties should not be taken to mean 'custom' as understood by lawyers, but means a settled and established practice of the port.⁵

The expression '*with usual despatch*' means the despatch of those who have the cargo ready on the dock for the purpose of loading.

Demurrage

If a claim in the form of damage suffered by ship-owners though the *improper detention* of the ship by the merchant is made, it fails

⁴ *Ford v. Cotesworth* (1870), L.R. 4, Q.B. 127-30.

⁵ *Postlethwaite v. Freeland* (1886), 5, App. Cas, 599-616.

under the heading of demurrage. This is strictly speaking a charge as liquidated damages for delay over and above lay days. This claim arises from a clause generally inserted in a charter-party or in a bill of lading. In the latter case it is to be found in the form of a marginal clause. A person claiming and receiving the goods under the bill of lading is answerable for this payment. *The rule* laid down in this connection by Lord Tenterden is recognized as fixed law on this point *viz.*—

“Where the time is expressly ascertained and limited by the terms of the contract, the merchant will be liable to an action for damages, if the thing be not done within the time although this may not be attributable to any fault or omission on his part; for he has engaged that it shall be done”.

The “lay days” commence to run from the moment of time the charterer has had notice of the ship’s arrival and readiness to take or discharge cargo. “Days” may be “running” or “working”. If they are not expressed to be “working days” they are to be taken to mean “running days” unless the custom of a particular port give some other meaning to those expressions as in the case of the Thames river custom dealt with above. It has also been held that the *charterer cannot set off time saved at the port of discharge against demurrage incurred at the port of loading*. The charter party usually states the number of “lay days” allowed for loading and unloading the cargo and also lays down the sum per day payable in case of delay exceeding the “lay days” allowed. If the “lay days” are named but the charge for demurrage is not specifically stated, the ship-owner can, notwithstanding, claim damages for the delay.

Bills of Lading

We have seen that a bill of lading is an indispensable complement of the charter-party where one is drawn out, but in the absence of a charter-party the bill of lading, besides forming an acknowledgment of the shipment of goods, also embraces the agreement of carriage. *When it is signed by master*, as is usually the case, he does so *as the agent of the ship-owner*. In the case of a general ship, charter-parties are not drawn out and the agreement of carriage is printed on the *bill of lading* itself, the conditions and terms of which correspond with those we have dealt with above in the case of charter-parties. There are a few peculiarities, however, with which we shall now deal. A bill of lading is held to be a good evidence of a contract of carriage in the case of a general ship.

As to the goods delivered, the captain may state either "*delivered in good order and condition*" or "*weight, contents and value unknown*". In the former case the captain is bound to deliver the goods in the same good condition as they were at the time of loading, the usual depreciation on the voyage being expected; the document in such cases would be known as a "*clean*" bill of lading. When goods are to be carried partly by sea and partly by land, and if the ship-owner charges a rate which covers the charge both for transit by sea and land then the bill of lading is called a *through bill of lading*.

The *peculiarity of a bill of lading* is that it is a *document of title to the goods* and in case the goods are made deliverable to the "*bearer*" or to a particular person or to his "*order*" or "*assigns*", the bill of lading can be transferred by the original holder to anyone he chooses, and the transferee in his turn can also *transfer it*. This transfer can be made *by endorsement or delivery*, as the case may be, and the transferee acquires, by such a transfer, all the rights as to the goods shipped that the transferor had and is also subject to the same liabilities as that of the transferor. If, therefore, a bill of lading is transferred by the shipper to some other person, whether such a person is the buyer, or his mercantile agent lawfully entrusted with the bill of lading and if that person, during the course of the transit of the goods, endorses the same in favour of some other person, who purchases the goods in good faith and for valuable consideration, the right of stoppage in transit of the original holder cannot be exercised against this last party.

A bill of lading is frequently described as a negotiable instrument though it is not one in the strict sense of the term. *There are undoubtedly many points of resemblance between a bill of lading and a negotiable instrument*, e.g., its transferability by delivery with or without endorsement and without any notice to the person liable on it, and also that the transferee of a bill of lading can sue in his own name and give a valid discharge to the person liable. Thus, some authors have called it a *quasi-negotiable document*. *It differs from a bill of exchange on the point of negotiability, because in the case of a bill of lading a holder cannot give a better title than he himself has*, whereas in case of a bill of exchange a holder in due course, who receives the bill for value and in good faith, receives it free from all defences as to defect in title as could have been successfully pleaded against a previous holder, except, of course, forgery.

The bill of lading is generally made out in a set of two or three. It sometimes happens that these get into the hands of two or three

different parties. In such cases the first transferee gets the best right at law. As far as the matter is concerned, if he *bona fide* hands over the goods to any one of these holders, he is free from responsibility to the person who happens to claim a prior right, because the bills of lading provide for this contingency by a clause usually inserted in them, laying down that as soon as one of these documents is accomplished the others stand void.

The ground on which this is done is well explained by Earl Selborne—

It is for the benefit of the shipper that the right to take delivery of the good is made assignable, and it is for the benefit and security of the ship-owner that when several bills of lading, all of the same tenor or date are given as to the same goods, it is provided that “the one of these bills being accomplished, the others are to stand void”. It would be neither reasonable nor equitable, nor in accordance with the terms of such a contract, that an assignment of which the ship-owner has no notice, should a *bona fide* delivery under one of the bills of lading, produced to him by person named on the face of it, as entitled to delivery in the absence of assignment from being a discharge to the ship-owner.

— Earl Selborne

Charter-Party different from a Bill of Lading

If the terms in a charter-party differ from those in a bill of lading issued by the charterer those in the charter-party would prevail, unless it has been expressly agreed to substitute the contract contained in the bill of lading for the contract in the charter-party.

General Ship

A contract for conveyance of merchandise of a general ship is defined in Abbot on Shipping as follows:—

A contract “by which the masters and owners of a ship detained on a particular voyage, engage separately with various merchants unconnected with each other, to convey their respective goods to the place of the ship’s destination. This contract, although usually made personally with the master, and not with the owners, is considered in law to be made with them also and that both he and they are separately bound to the performance of it”.

“It would be noticed here that the captain is also personally responsible for the performance of the contract. The captain, no doubt, acts and signs such contracts on behalf of his masters who are principals, but the reason why he is made personally responsible is that “the law will not compel the merchant to seek after the owners and sue them, although it gives him the power to do so; but leaves him a twofold remedy against the one or the other.”

— Abbot on Shipping

The *bill of lading* was defined by Mr. Justice Shee as—

“The written acknowledgement of the master that he has received the goods from the shipper to be conveyed, on the terms therein expressed, to their destination and there delivered to the parties by him designated. The master, therefore,

should be careful not to sign bills of lading, until the goods are actually delivered to him, or to permit the insertion of statements in the bill of lading at variance with the fact."

— Justice Shee

We have seen that *where a charter-party is not made out, the bill of lading contains the contract of carriage*. Here, however, it should be added that *unless the captain has received the goods there cannot be a contract in the case of a bill of lading*; because the captain, at law, has no authority to make a contract of carriage to bind the ship-owner except in the case of the goods received by him to be carried. It may, however, be noted that many judges have treated bills of lading with printed terms and conditions of the contract of carriage as if they were independent contracts. Lord Bramwell, however, objects to this description. According to His Lordship, the statement in the English Bills of Lading Act, 1855, which refers to the contract as "the contract contained in the bill of lading" is erroneous, because His Lordship's idea seems to have been that there is no such contract contained in the instrument, and that all it presents is a receipt for the goods which also states "the terms on which they were delivered to, and received by, the ship and, therefore, forms excellent evidence of these terms, but it is not a contract. This has been made before the bill of lading was given".

According to Lord Esher—

"The terms of Bill of Lading Act (English) show that the legislature looked upon a bill of lading as containing the terms of contract".

In short, *conclusion* one can arrive at after going through the various decisions on this point, seems to be that *whether a bill of lading is in itself a contract or not, it is undoubtedly a valid document evidencing the terms and conditions printed on it, and therefore, serves the same purpose as a written contract would have done*.

Marked and Numbered

The shipper has to make and *consecutively number* all his packages. He has to select a *distinctive mark* by which his goods are to be distinguished from those of others, and these *marks and numbers* are to be stated on the margin of the bill of lading. There is also a clause in the bill of lading stating that if any of these marks are obliterated and in consequence thereof the goods were to go astray, the ship-owner would not be responsible for the loss.

Loss by Prolongation of Voyage

It happens that the voyage for various reasons takes more time than usual, in which case goods of a perishable nature get damaged or

spoiled. A special clause in bills of lading always exempts the ship-owners from such a risk.

Salvage

It often happens that the ship or its cargo may have to take the assistance of some other ship in case of accidents, breakdown etc. *The owner of the ship which renders this assistance is entitled to be remunerated for his trouble. Such remuneration is called "salvage".* This salvage would have to be borne by the cargo-owner if the assistance was rendered with a view to save the cargo. If, both the ship and cargo were assisted, the ship-owner as well as the cargo owner should contribute. In case all or any of these were insured, the insurance company or the underwriters would make good the loss.

The salver can claim his salvage only in those cases *where assistance has proved to be beneficial*, in which case he also acquires a *lien for his salvage* on the property salvaged.

"Through" Bill of Lading

The goods on some occasions have to be carried partly across the sea and partly by land, and the ship-owner generally charges a *rate which covers the charge both for the transit by sea and land*. In such cases he issues what is called a "through" bill of lading.

The Master of the Ship

The master of a ship represents the ship-owner as his agent for various purposes. He signs the bills of lading as the owner's agent except where the ship is chartered and the charterer puts the ship as a general ship, when the master may sign the bill of lading as the charterer's agent. *His duties* include the care of the ship entrusted to his charge, navigating it in proper manner and starting on the voyage as per instructions. He is empowered to do all that is usual and necessary in the usual course of the employment of the ship. He must deliver the cargo at its destination in proper condition and to the proper party. He can deviate from his ordinary course when he thinks deviation necessary in order to save the ship from peril. If he cannot proceed on the voyage for good reasons he has also the power to tranship the goods to some other steamer. He may also, when absolutely necessary, enter into a salvage agreement on behalf of the ship-owner as well as the cargo-owner.

He can make contracts and give warranties in the course of his usual employment which would be binding on the owner, though

the master himself is personally liable on such contracts and the party can sue both of them.

Hypothecation

When the master needs money for the *necessary* purposes of the voyage, he may raise it by *hypothecation* if he cannot communicate with the owner or procure money by any other means. Hypothecation has been *defined* by Potheir as "a right which a creditor has in or to the property of his debtor, in virtue of which he may cause it to be sold and the price appropriated in payment of his debt". Hypothecation *differs from a mortgage*, in that there is no conveyance of the property appropriated for payment of the debt or loan and *from a pledge* in that there is no actual or constructive delivery of the property.⁶

Bottomry Bond

When the master is in urgent need of *money in the interests of the cargo*, which he cannot raise in the owner's credit and is *unable to communicate with the owner*, he has the power to give a bond known as a "bottomry bond" by which *he pledges or hypothecates the 'bottomry' i.e., the whole ship or the ship and cargo as a security to the person advancing money*. The advance is at a hazard and the lender has a *maritime lien on the ship itself*.

The *peculiarity* of this bond is that *the capital and interest on the loan is payable only if the ship reaches its destination*. If, therefore, after this bond is given, the master proceeds with the voyage and has, at some other port, to raise further money for urgent repairs for which he gives a second "bottomry bond" to some other person, *this second person acquires a prior right over that of the lender on the first bond*. If, however, after setting out on a voyage the same cannot be completed, or has to be abandoned, either owing to any act of the master, or through some impossibility which the bond holder cannot control, the bond becomes due and payable. Where the ship is totally lost, the bond becomes void; but if a part of it is saved the amount of the bond can be recovered therefrom.

"Respondentia"

When money is borrowed on the security of the cargo alone the bond is known as *respondentia*. In this case also, the captain must

⁶ Coote's Law of Mortgages.

in the first instance try to communicate with the cargo-owner, and this money should have been borrowed *exclusively for the benefit of the cargo*.

In extreme cases, specially where the goods are damaged, the master may sell them; but here too he must, wherever possible, obtain the consent of the cargo-owner. Where the master cannot raise the necessary money to enable him to proceed with the voyage, either on the credit of the ship-owner, or on his own credit, or is unable to communicate with the owner, he may sell a part of the cargo in order to be able to carry the rest to its destination. The master can "*jettison*" or *throw overboard a part of the cargo in order to save the rest*. The cargo-owners, in such cases, are *generally entitled to an average contribution*. The master must keep official records and is also responsible for any fraudulent conduct on his own part when such conduct affects the interest of the owners.

Master's Right of Transhipment or Sale

In cases where the master finds that by reason of the damage done to the ship he cannot proceed with the voyage without much loss of time he has the liberty to secure another ship to carry the cargo. Where the cargo is of a *perishable nature* and consequently transhipment cannot be effected and if there is no time to consult the cargo-owner, the captain can sell the goods at the best available price. This power should be exercised with due caution and only as a last resort.

Master's duty to take care of the Goods

According to Mr. Justice Wills—

"It is duty imposed upon the master, as representing the ship-owner, to take reasonable care of the goods entrusted to him, not merely in doing what is necessary to preserve them on board the ship during the ordinary incidents of the voyage, but also in taking reasonable measures to check and arrest the loss, destruction, or deterioration, or by reason of accidents, for the necessary effects of which there is, by reason of exception in the bill of lading, no original liability".

— *Justice Wills*

SUMMARY

Types of Carriers

- (1) Private carriers
- (2) Common carriers

Duties and Liabilities

Private carrier

1. Governed by the Contract Act
2. Liable as a bailee
3. Can pick and choose his customer
4. May or may not receive compensation
5. Casual carrier

Common carrier

1. Governed by the Common Law of England as modified by the Carriers Act, 1865
2. Liable as an insurer
3. Must carry for all indiscriminately
4. Is paid for his services
5. Regular public carrier

CARRIAGE BY RAIL

Liability of Railways: Common carriers for animals and goods under Railways Act, 1890, as amended in 1961.

Risk Notes

- (1) Owner's Risk Rate—Liability is that of a bailee.
- (2) Railway Risk Rate—Liability is that of a common carrier

CARRIAGE BY AIR

Law Applicable: Carriage by Air Act, 1934 which adopted the Warsaw Convention of 1920.

Liability of Carrier: In the case of—

- (1) Passengers—limited to 125,000 francs.
- (2) Registered luggage and other goods—limited to 250 francs per kilogram.
- (3) Goods in charge of passenger—limited to 5,000 francs per passenger.

Documents of Carriage

- (1) Passenger ticket—for passengers.
- (2) Luggage ticket—for registered luggage.
- (3) Air consignment note—for goods.

CARRIAGE BY SEA

Law applicable: Bills of Lading Act, 1856, and Carrier of Goods by Sea Act, 1925.

Contract of Affreightment: A contract of affreightment is a contract for the carriage of goods by land or sea for a price in money. Freight is the consideration for the carriage of goods.

Documents Containing Contracts of Carriage by Sea

- (1) Charter Party
- (2) Bill of Lading

Charter Party

1. An agreement for the hire of a ship or a part of it.
2. Not an acknowledgment of receipt of goods on board.
3. Not a document of title.
4. No resemblance to a negotiable instrument.

Bill of Lading

1. An agreement for the carriage of goods by sea when there is no charter party.
2. An acknowledgment of the receipts of goods on board.
3. A document of title.
4. A quasi-negotiable instrument.

Types of Freight

- (1) Simple freight
- (2) Advance freight
- (3) Dead freight
- (4) Lump freight
- (5) Back freight
- (6) Time freight
- (7) Freight pro rata

Methods of Borrowing Hypothecation

- (1) Bottomry Bond—ship, freight and cargo are charged
- (2) Respondentia—cargo alone is charged.

QUESTIONS

1. 'The rule of common law is that a common carrier is an insurer of the safety of the goods entrusted to him, and is therefore liable for any loss or damage, whether caused by his negligence or not'. Comment. State the exceptions to the rule.

2. *M*, who was *R*'s agent, delivered at Kota 10 bales of cotton to the Kota Transport Co., a common carrier, to be carried to Mangrol and delivered there to *R*. The cotton was carried in a gas plant truck and while in transit the truck caught fire and the cotton was totally destroyed. *R* sued the transport company for the payment of the value of the undelivered cotton. In defence, the transport company pleaded that *D*, who had brought the cotton to them for carriage, had, when warned of the risk, agreed that the cotton be taken at his risk and responsibility. *D* had no authority from *R* to do so. The transport company also pleaded the absence of privity of contract between them and *R*. Decide and state the law in support of your decision.

3. Distinguish a Charter-party from a Bill of Lading. By a Bill of Lading goods are shipped by *A* deliverable to *B* or assigns. Freight is payable on delivery. The Bill of Lading is negotiated for value by endorsement and delivery with the intention of passing the property in the goods, and so comes in the hands of *E*. Is *B* or *E* liable for the freight? Can *E* recover against the shipowner if the goods are lost on the voyage?

4. State the importance of the clause relating to (1) Seaworthiness and (2) Negligence, in a Charter Party. What is meant by "Deviation" on the part of ship and how does it affect the liability of an underwriter?
5. Explain— Dead freight; Lay days; Salvage; General Average; Clean Bill of Lading.
6. Explain the effect of the "excepted perils" clause in a charter party. How does it affect the protection given to the shipowner by this clause, if he deviates from his course, and in what cases is such deviation allowed?
7. *A* sells and consigns goods to *B* of the value of Rs 12,000. *B* assigns the Bill of Lading for these goods to *C* to secure a sum of Rs 5,000 due from him to *C*, upon a general balance of account. *B* becomes insolvent. *A* has not received the whole price of the goods. Is *A* entitled to stop goods in transit?
8. State the circumstances under which the master of a ship can enter into contracts of respondentia or bottomry to as to bind the owner. To whom and by whom is freight payable?
9. "The common law liability of the ship-owner as a carrier was precisely the same as that of a land carrier." Explain with a short note on the present-day liabilities of a shipowner.

Chapter 22

MORTGAGES AND CHARGES

MORTGAGES

THE TRANSFER of Property Act, 1882 deals with mortgages of immovable property. References in this chapter to sections will therefore be to the sections of that Act unless otherwise stated.

Definition of Mortgage

A *mortgage* is the transfer of an interest in specific immovable property for the purpose of securing the payment of money advanced or to be advanced by way of loan, an existing or future debt, or the performance of an engagement which may give rise to a pecuniary liability. The transferor is called a *mortgagor* and the transferee a *mortgagee*. The principal money and interest of which payment is secured for the time being are called the *mortgage-money* and the instrument (if any) by which the transfer is effected is called the *mortgage deed* [S.58(a)]. No particular form of words is necessary to create a mortgagee.

Essentials of a Valid Mortgage

The essentials of a valid mortgage are—

- (1) There must be a transfer.
- (2) The transfer must be of an interest.

In a mortgage the whole of the interest of the mortgagor does not pass to the mortgagee, for if it did, the transaction would be a sale. The rights of ownership remain with the mortgagor in addition to a right to redeem the property on repayment of the debt. The mortgagor, as such owner, has the right to sell the property. Of course, in such a sale, the purchaser would take the property subject to the mortgage. The mortgagor can also create a second mortgage. Though a mortgage may be created in several forms (as will be seen later), in every form of mortgage the mortgagor retains his ownership of the property mortgaged. Before the contractual date for repayment has elapsed he has a legal interest in the subject-matter; after the contractual date for repayment has elapsed, he has a legal right of redemption given by Section 60. Thus the whole of the interest of the mortgagor in the property mortgaged never passes to the mortgagee.

(3) The interest transferred must be in specific immovable property.

Though the Transfer of Property Act does not deal with them there can be mortgages of movable property also.

(4) There must be a mortgagor, *i.e.*, the transferor and a mortgagee, *i.e.*, the transferee.

A minor cannot transfer by mortgage. A minor though incompetent to transfer is capable of holding property. A minor therefore can be a mortgagee and provided a minor has advanced the whole of the mortgage money a mortgage can be enforced by him or on his behalf.¹

(5) The purpose or object of such transfer must be to secure a debt.

The debt to be secured may be not only a specific sum but the balance of a current or a running account between the parties upto a specified maximum.

Classification of Mortgage

The Transfer of Property Act enumerates the following six kinds of mortgages—

- (1) Simple mortgage.
- (2) Mortgage by conditional sale.
- (3) Usufructuary mortgage.
- (4) English mortgage.

¹ *Raghava v. Srinivasa*, [1917] 40 Mad. 308[F.B.]

- (5) Mortgage by deposit of title deeds or Equitable mortgage.
- (6) Anomalous mortgage.

Simple Mortgage

A simple mortgage is a transaction whereby, without delivering possession of the mortgaged property, the mortgagor binds himself personally to pay the mortgage-money and agrees, expressly or impliedly, that in the event of his failing to pay according to his contract, the mortgagee shall have a right to cause the mortgaged property to be sold and the proceeds of sale to be applied, so far as may be necessary, in payment of the mortgage-money [S.58(b)].

The essentials of a simple mortgage are—

(1) *A personal obligation on the part of the mortgagor to pay the mortgage-money. The personal obligation may be express or implied. Where there is no express obligation, the acceptance of a loan implies a promise to pay.*²

(2) *The transfer to the mortgagee expressly or impliedly of the right "to cause the property to be sold" in the event of the mortgagor failing to pay according to the contract. The sale must be through the intervention of the Court and this is indicated by the use of the words "cause the mortgaged property to be sold."*³ Thus in order to exercise his right of sale a simple mortgagee has to obtain first a decree in a mortgage suit. He cannot sell the property himself without obtaining such a decree. Thus in a simple mortgage there is a two-fold security for the debt—

- (1) the personal obligation of the mortgagor, and
- (2) the property.

In a simple mortgage the mortgagee is not put in possession of the property. *A simple mortgage, therefore always requires to be registered* whatever the amount of the principal money secured "A simple mortgage corresponds to the *hypothecation* of the Roman Law and the systems founded upon it. In a pure simple mortgage the mortgagee is not put into possession of the property pledged (*sic*) to him. He has not, therefore, the right to satisfy the debt out of the rents and profits, nor can he acquire the absolute ownership of the estate by foreclosure. To borrow the language of English Law, a simple mortgage is in the nature of an equitable charge".⁴

² *Sutton v. Sutton*; [1882] 22 Ch. D. 511, 515 C-A; *Yeshwant v. Vithal*, [1897] 21, Bom. 267, 270

³ *Krishanlal v. Ganga Ram*, [1891] 13 All. 28

⁴ Ghose's "The Law of Mortgage in India", *Tagore Law Lectures*, 5th Ed., Vol. I. p. 81

In a simple mortgage when the mortgagor sells the property the vendor takes the property subject to the mortgage but not subject to the personal obligation of the mortgagor because such personal obligation being the burden of a contract cannot be assigned without the consent of the mortgagee. Thus, if X executes a simple mortgage in favour of Y and then sells the property to Z and Y files a mortgage suit and obtains a decree but in execution of such decree does not realise the whole amount on the debt, he can recover the balance only from X and not from Z.

• Mortgage by Conditional Sale

A mortgage by conditional sale is a transaction whereby the mortgagor *ostensibly sells* the mortgaged property *on condition* that—

- (1) on default of payment of the mortgage-money on a certain date the sale shall become absolute, or
- (2) on such payment being made the sale shall become void, or
- (3) on such payment being made the buyer shall transfer the property to the seller.

The transaction is not to be deemed to be a mortgage unless the condition is embodied in the document which effects or purports to effect the sale [S. 58 (c)].

The *essentials of a mortgage by conditional sale are—*

- (1) It is an ostensible sale and not a real sale.
- (2) Such ostensible sale is subject to a condition.
- (3) In default of payment the ostensible sale ripens into a real sale.
- (4) On payment the mortgagee has to re-transfer the property to the mortgagor.
- (5) The mortgagor does not undertake any personal liability as in the case of a simple mortgage.
- (6) It is a non-possessory mortgage, *i.e.* the possession of the property mortgaged is not delivered to the mortgagee.
- (7) The condition must be embodied in the very same document which effects or purports to effect the sale.
- (8) The remedy of a mortgagee by conditional sale is by foreclosure only and not by sale.

The mortgagee has to rest content *only* with *foreclosing* the mortgaged property. As there is *no personal liability* undertaken by the mortgagor the mortgagee cannot look to the other properties of the mortgagor in case the mortgaged property prove insufficient.

On breach of the condition of payment within the stipulated period the contract exhausts itself and the transaction is closed and becomes one of sale to be enforced by foreclosure. A mortgagee cannot, therefore, give up the condition as to sale and treat the mortgage as an ordinary one.⁵

Mortgages known in Bengal as Kat-Kobala, in Uttar Pradesh as Bye-bil-wafa and in Bombay as Gahan Lahan, are in effect mortgages by conditional sale.

Usufructuary Mortgage

A usufructuary mortgage is a transaction in which,

(1) the mortgagor delivers possession or expressly or by implication binds himself to deliver possession of the mortgaged property to the mortgagee, and

(2) authorises him

(a) to retain such possession until payment of the mortgage-money, and

(b) to receive the rents and profits accruing from the property or any part of such rents and profits and to appropriate the same (i) in lieu of interest, or (ii) in payment of the mortgage money, or (iii) partly in payment of the mortgage money [S. 58(d)]. The mortgagee is called an usufructuary mortgagee.

The *essentials of a usufructuary mortgage* are—

(1) It is a *possessory mortgage*, i. e. the mortgagee is put in possession of the mortgaged property.

It is not essential that the mortgagee should take actual physical possession. The mortgagor may continue in possession as the lessee of the mortgagee,⁶ or the mortgagor may direct the tenants to pay rent to the mortgagee.⁷

(2) The mortgagee has *right to enjoy the rents and profits* until that debt is paid. The rents and profits or part of the rents and profits may be appropriated in lien of (a) interest, (b) principal or (c) principal and interest. In the first case a mortgagee is not required to keep accounts (See S. 77); in the other two cases an account is necessary.

(3) There is no *personal liability* on the mortgagor. In a pure usufructuary mortgage, the mortgagor does not undertake any per-

⁵ (*Badri v. Besu*, A.I.R. 1933 Lah, 174).

⁶ *Feroze Khan* (1933) 60 I.A. 273

⁷ *Venkataraman v. Varahaliah* A.I.R. 1932 ad. 768

sonal liability. A personal covenant is, however, often included in order to give a personal remedy against the mortgagor. The mortgage then, strictly speaking, is not a usufructuary mortgage but an anomalous mortgage.

(4) There is *no time limit* fixed; the mortgagee remains in possession until the debt is repaid.

(5) The *remedy* of a usufructuary mortgagee is to continue in possession and enjoyment until the debt is repaid. A usufructuary mortgagee cannot bring a suit for foreclosure or sale (S. 67). If, however, the mortgagor fails to bring a suit for redemption within 60 years, the mortgagee becomes the absolute owner of the property. In Bengal a usufructuary mortgage is known as Khai Khalasi, and in Madras as Bhogyam or Bhogya Bandhaka or Swadina Adamanum.

English Mortgage

An English mortgage is a transaction in which the mortgagor binds himself to repay the mortgage-money on a certain date and transfers the mortgaged property absolutely to the mortgagee, but subject to a proviso that he will re-transfer it to the mortgagor upon payment of the mortgage-money as agreed [S. 58(e)].

The *essentials of an English mortgage* are—

(1) The mortgagor should bind himself to repay the mortgage money on a certain day, *i.e.*, there should be a *personal covenant* to pay.

(2) The property mortgaged should be *transferred absolutely* to the mortgagee.

(3) Such transfer should be *subject to a proviso* that the mortgagee would re-transfer the property to the mortgagor upon the mortgagor making payment of the mortgage-money as agreed.

Even though the words used in the section are “transfers the mortgaged property absolutely to the mortgagee”, it does not follow that all the right, title and interest of the mortgagor is transferred to the mortgagee. What is meant is that such a mortgage would be absolute were it not for the proviso for transfer.⁸

English Mortgage and Simple Mortgage

(1) In both there is a personal covenant to pay on the part of the mortgagor.

⁸ *Ram Kinkar v. Satya Charan*, 41 Bom. L.R. 672 P.C.

(2) The remedy by foreclosure is not available in both.

(3) In an English mortgage the mortgagee being in the nature of an owner of the property has the right to enter into immediate possession. In a simple mortgage there is no such implication of ownership and no right to take possession.

(4) Though the remedy of both is sale, an English mortgagee has a right under certain circumstances to sell without the intervention of the Court. A simple mortgagee never has that right.

English Mortgage and Mortgage by Conditional Sale

(1) In an English mortgage there is personal covenant to pay on the part of the mortgagor. There is no such personal covenant in a mortgage by conditional sale.

(2) In an English mortgage the mortgagee is entitled to enter into immediate possession of the property mortgaged. A mortgagee by conditional sale has no right to enter into possession.

(3) The remedy of an English mortgagee is by sale. The remedy of a mortgagee by conditional sale is by foreclosure.

Mortgage by Deposit of Title-Deeds

When a person *delivers* in the towns of Bombay, Calcutta and Madras and in other towns as may be specified by the State Government by notification in the official Gazette in this behalf, to a creditor or his agent documents of title to immovable property, with intent to create a security thereon, the transaction is called a mortgage by deposit of title-deeds [S. 58(f)]. Thus such a transaction creates a mortgage in favour of the creditor in respect of the property to which the title-deeds relate.

In *English Law* a mortgage by deposit of title-deeds is called an equitable mortgage. As Lord Cairns observed in *Shaw v. Foster*, (1872) L.R., 5 H.L. 321, 340, "It is a well-established rule of equity that a deposit of documents of title without more, without writing, without word of mouth, will create in equity a charge upon the property referred to". There are, however, certain important points of difference between the English and the Indian law. In English law only an equitable security is created so that the equitable mortgage creates only a personal right against the mortgagor and is unenforceable against a *bona fide* purchaser for value of the legal estate without notice of the creation of the equitable estate. In India there is no distinction between an equitable and a legal estate and thus in

India a mortgage by deposit of title-deeds gives rise to a right *in rem* i.e., the property itself available against the whole world so that it cannot be defeated by a *bona fide* purchaser.

The *essentials of a mortgage by deposit of title-deeds* are —

- (1) A debt.
- (2) Delivery of the title-deeds to the creditor or his agent.
- (3) An intention to create a security on the debt.

Delivery means delivery of actual possessions, and if it is to the mortgagee's agent it must be to him *qua* agent. The property may be situated outside the specified towns,⁹ but the delivery must take place within the limits of one of those towns. All the title-deeds of the property need not be deposited. It is sufficient if those actually deposited constitute material evidence of the mortgagor's title.

The *effect of a mortgage by deposit of title deeds* is that as there is no difference between an equitable and a legal mortgage in India, a mortgage by deposit of title-deeds prevails against a subsequent, registered mortgage of the same property. Thus an intended mortgagee should for his own safety call for the title-deeds and not only rely on the records of the Registration office. An equitable mortgage creates a right *in rem* and not a right *in personam* and is not liable to be defeated by a subsequent purchaser for value without notice.

The remedy of the equitable mortgagee is a *decree for sale* whereas the mortgagor's remedy is a suit for redemption. He cannot bring an action in detinue to recover the title-deeds.

Anomalous Mortgage

A mortgage which is not a simple mortgage, a mortgage by conditional sale, an usufructuary mortgage, an English mortgage or a mortgage by deposit of title-deeds is called an anomalous mortgage [S.58(g)].

An anomalous mortgage is, like other types of mortgage, a transfer of an interest in specific immovable property for the purpose of securing the payment of debts, present or future, or for the performance of an obligation which may result in pecuniary liability. It is, however, a type of mortgage other than those which are defined in the section. Such a mortgage would include a transaction formed by the combination of a simple and an usufructuary mortgage,

⁹ *Bohram v. Sorabji* 39 Bom. 372.

namely, a simple mortgage usufructuary or by the combination of a mortgage by conditional sale and an usufructuary mortgage namely, a mortgage usufructuary by conditional sale. Anomalous mortgages take various forms depending on custom, local usage or contract.

Sub-mortgage

A sub-mortgage is a mortgage of the mortgagee's interest. As a mortgage debt is immovable property a mortgagee may assign his interest in the property either absolutely or by way of mortgage. Such a transfer *requires registration*, being a transfer of immovable property. A sub-mortgage being a mortgage *must also be attested*. If the sub-mortgagee wishes to bind the original mortgagor, he must give notice to him, otherwise if the original mortgagor pays off the mortgagee in ignorance of the sub-mortgage, the sub-mortgagee will not be entitled to hold the mortgagor liable. However, a payment by the original mortgagor to his mortgagee after notice of the sub-mortgage will not bind the sub-mortgagee.

Mode of Transfer

A registered instrument is necessary in the case of a mortgage other than a mortgage by deposit of title-deeds, if the principal money secured is Rs 100 or upwards. Besides registration, the instrument must be signed by the mortgagor and attested by at least two witnesses. If the principal money secured is less than Rs 100, a mortgage may be made either by a registered instrument or by delivery of possession. A simple mortgage must always be registered as the mortgagor does not part with possession and the mortgagee may be easily deceived if registration were not compulsory. Equitable mortgages are exempted from registration in order to facilitate the quick despatch of business in the specified commercial towns. It should be remembered that a mortgage becomes complete as soon as the deed is registered but when registered it takes effect as from the date of execution.

Effect of Non-Registration

If an instrument which requires registration is not duly attested and registered the mortgage is void but (1) the instrument may be used to establish a personal covenant to pay and (2) if possession has been delivered under it, the doctrine of part-performance may be applied.

Rights of the Mortgagor

A mortgagor has the following rights—

(1) *Redemption*, that is, after the principal money has become due and on proper payment or tender of the mortgage-money the mortgagor is entitled to get back his property and ask for (a) the mortgage instrument, title-deeds and all other documents relating to the property, (b) delivery of possession when the mortgagee is in possession, and (c) a re-transfer of the property or written acknowledgment of the extinction of the mortgagee's right (S.60). The right to redeem is a natural incident of a mortgage. It is a statutory right which cannot be taken away from the mortgagor by any law or contract. Similarly there are two other indefeasible rights, namely, the right to compel transfer to a third party, and the right to inspect documents. A mortgagor may, however, contract himself out of any or all the other rights enumerated below.

The right of redemption is made indefeasible because if the right of redemption is taken away a mortgage would cease to be a mortgage and become instead an absolute transfer. This is contrary to the fundamental rule of law, namely, "once a mortgage always a mortgage". This rule is, however, subject to the statutory limitation that the mortgagor must bring his suit for redemption within three years.¹⁰

According to the Common Law of England, the mortgagor's right of redemption was lost on failure to exercise it within the time specified. The Court of Chancery, however, gave him the *equity* of redemption although he had lost the *right* of redemption. This distinction, however, is not recognised in India where the expressions right of redemption and equity of redemption are synonymous terms. Thus any stipulation in the contract which interferes with the mortgagor's right of redemption is referred to as a clog on the equity of redemption and is invalid. In *Noakes & Co. v. Rice*.¹¹ Rice mortgaged his premises to Noakes & Co. who were brewers, with a stipulation that Rice should not sell on the premises either during the continuance of the mortgage or afterwards any liquors which not prepared by Noakes & Co. It was held that the condition was a clog.

The right of redemption is an *indivisible right* and mortgaged property cannot be redeemed in part.

¹⁰ [The Limitation Act, 1963]

¹¹ 1902 A.C. 24

(2) To compel the mortgagee to transfer to third person instead of re-transference to the mortgagor (S. 60A). This enables a mortgagor to find out a financier when he is in difficulty, and so save himself from the hands of the mortgagee.

Three conditions are, however, necessary for the exercise of this right:

- (i) the right of redemption must be subsisting;
- (ii) the right to re-transfer must be made a distinct stipulation of the transaction; and
- (iii) the mortgagee must not be in possession of the mortgaged property.

(3) To inspect and make copies of all documents of title which are in the mortgagee's custody or power (S. 60 B).

(4) To redeem one of two properties mortgaged to the same mortgagee and thereby avoid "consolidation" by the mortgagee of two separate mortgages (S. 61).

"Consolidation" refers to the mortgagee's power to compel the mortgagor to redeem all the securities in favour of the same mortgagee or to prevent him from redeeming some without redeeming all.

(5) To recover possession of the property as well as of the mortgage deed and all documents relating thereto in case of a usufructuary mortgage (S. 62). This right is available *only in two cases*:
(a) Where the mortgage money is to be paid out of rent and profits of the property this right accrues as soon as such money is paid, and
(b) where a portion of the mortgage money is to be paid out of rents and profit and when the principal sum or balance thereof has been paid or tendered or been deposited in Court after it has become due.

(6) To get all accession to the property during the continuance of the mortgage: (a) The mortgagee can claim the expense he has incurred in acquiring the accession where it is capable of separate enjoyment without detriment to the principal property. (b) The mortgagee cannot claim any expenses where the accession is not capable of separate possession or enjoyment and the accession was necessary to preserve the property and was made with his assent. The mortgagee can claim such cost but not if the acquisition is voluntary (S. 63.)

(7) To be entitled to all improvements to mortgaged property (S. 63A).

(8) To get the benefit of the renewal of the lease by the mortgagee where the mortgaged property is a lease (S. 64).

(9) To grant a lease of the mortgaged property where the mortgagor was lawfully in *possession* of the property (S. 65A).

Liabilities of Mortgagor

The mortgagor has two types of liabilities: (1) Implied liabilities which may be varied by a special contract to the contrary (S. 65). Liability for active waste which obligation cannot be removed by a contract to the contrary (S. 66). The mortgagor is not liable for permissive waste.

Implied Covenants by the Mortgagor

The following are the implied contracts by the mortgagor.

(1) An implied warranty of title, *i.e.* the mortgagor is deemed to contract, that the interest which he professes to transfer exists and that he has the power to transfer it.

(2) An implied covenant to indemnify the mortgagee against all expenses for protecting his title, *i.e.* the mortgagor undertakes to defend or enable the mortgagee to defend the mortgagor's title.

(3) An implied agreement to pay all public charges during the time mortgagor is in possession.

(4) An implied agreement, in case the mortgaged property is a lease that the mortgagor has up to the time of the mortgage paid all the rents and performed all the conditions in the lease and that he will continue to do so and in case of default will indemnify the mortgagee against all claims arising therefrom. This undertaking does not apply in case the mortgagee is in possession.

(5) An implied undertaking that the mortgagor will pay regularly the interests on all prior mortgages from time to time as well as the principal money when it becomes due (S. 65).

The *benefit* of all the abovementioned implied covenants *runs with the land* but not the burden. Thus the assignee of the mortgagee is entitled to such benefits but the burden remains with the mortgagor alone and does not pass to a purchaser of the equity of redemption.

Rights of the Mortgagee

The following are the rights of a mortgagee:—

1. **Right to Foreclosure:** Foreclosure is the right of the mortgagee to institute a suit for a decree that the mortgagor be absolutely

debarred of his right to redeem. The right to foreclose arises only when the time fixed for repayment of the mortgage money has expired and the mortgagor's right to redeem has become complete but he has not exercised it. The right to foreclose unlike the right to redeem is subject to a contract to the contrary (S, 67). As the remedy of foreclosure involves a certain amount of hardship on the mortgagor, the Indian law allows it only in the case of a mortgage by conditional sale or an anomalous mortgage, where by express agreement the parties have stipulated for foreclosure. A suit by a mortgagee (1) for foreclosure must be brought within 30 years from the time when the money secured by the mortgage becomes due, and (2) for possession of immovable property mortgaged within 12 years from the time when the mortgagee becomes entitled to possession.¹²

2. **Right of Suit for Sale:** Instead of a decree for foreclosure the mortgagee may bring a suit for sale.

The *distinction between foreclosure and sale* is that in the case of foreclosure the mortgagor is absolutely debarred of his right of redemption and the mortgagee becomes the absolute owner of the property. In a sale he obtains the actual value of the property in money. The remedies of foreclosure and sale cannot be exercised by *mortgagees of public works* on grounds of public policy. In such cases the proper remedy is to appoint a *receiver*.

3. **Right to Sue for Mortgage Money:** As a general rule a mortgagee has no personal remedy against the mortgagor but in the following circumstances he may bring a suit for the mortgage money—

(a) When a mortgagor has personally bound himself to repay.

(b) When the mortgage security is wholly or partially destroyed or the security is rendered insufficient and the mortgagor fails to make it good after reasonable notice provided such destruction, etc. is not due to the fault of the mortgagor or mortgagee *e.g.* by fire, flood, force, *vis major*, etc.

(c) When the mortgagee is deprived of his security through the wrongful act or default of the mortgagor, for example, where the mortgagor fails to pay off a prior mortgage or fraudulently conceals from the mortgagee the existence of a prior incumbrance.

(d) When the mortgagee is entitled to possession, but the mortgagor fails (i) to deliver possession or (ii) to guard such possession against disturbance by a person claiming a superior title (S. 68).

¹² The Limitation Act, 1963.

A suit to enforce payment of money secured by a mortgage or otherwise charged upon immovable property is to be brought within 12 years from the time when the money sued becomes due.¹²

4. **Right to Sell without Court's Intervention:** In the following cases a mortgagee is entitled to sell the mortgaged property without the necessity of bringing a suit for sale—

(a) In the case of an English mortgage, provided neither party is a Hindu, Mohammedan or Buddhist.

(b) If such a power is expressly conferred by the mortgage deed and the mortgagee is the Government.

(c) If such a power is expressly conferred and the mortgaged property or any part of it was on the date of the execution of the mortgage deed situated within the towns of Madras, Calcutta, Bombay and certain other specified towns.

In order to exercise this right, (i) a written notice requiring payment of the mortgage-money has to be served on the mortgagor or one of several mortgagors and default should have been made for 3 months after such service, or (ii) interest amounting to not less than Rs 500 should be in arrear for 3 months after it has become due. (S. 69). A mortgage having the right to exercise a power of sale is entitled to appoint a receiver of the income of the mortgaged property. Such receiver is to be appointed by a writing signed by the mortgagee or on his behalf (S. 69A). When the power of sale has been improperly exercised the purchaser's title is not affected but the aggrieved party can claim damages from the person exercising such power. A sale under this power destroys the equity of redemption and transfers an absolute estate to the purchaser.

5. **Right to Spend Money:** A mortgagee has the right to spend such money as is necessary.

(a) for the preservation of the mortgaged property from destruction, forfeiture or sale when the mortgagor has been called upon and has failed to take proper and timely steps to preserve the property;

(b) for supporting the mortgagor's title to the mortgaged property when the mortgagor has been called upon and has failed to take proper and timely steps to support his title;

(c) for making his own title good against the mortgagor; and

(d) when the mortgaged property is a renewable lease-hold, for the renewal of the lease (S.72).

¹² The Limitation Act, 1963

Unless there is a contract to the contrary the mortgagee may add the money so spent by him to the principal money at the same rate of interest as is provided in respect of the principal money or, where no rate of interest is fixed, at the rate of 9 per cent per annum.

6. Right to Insure the Property: When the mortgaged property is by its nature insurable, the mortgagee has the right to insure and keep insured the mortgaged property against the loss or damage by fire. The mortgagee is entitled to add the amount of premiums paid to the principal money with interest at the same rate as is payable on the principal money, or where no rate of interest is fixed, at the rate of 9 per cent per annum. The amount of insurance is not to exceed the amount specified in this behalf in the mortgage deed or where no such amount is specified, two-thirds of the amount required in case of total destruction to reinstate the property.

A mortgagee is not entitled to insure (a) if there is a contract to the contrary, or (b) if a necessary insurance is kept up by or on behalf of the mortgagor (S.72).

7. Right to Proceeds of Revenue Sale: Where owing to failure to pay arrears of revenue or other charge of a public nature or rent due, the mortgaged property or any part thereof or any interest therein is sold, the mortgagee is entitled to claim payment of the mortgage-money out of any surplus of the sale proceeds remaining after payment of the arrears and of all charges and deductions directed by law. This section of course applies to a sale free from encumbrances as otherwise the mortgagee can enforce his right against the property in the hands of the purchaser. The claims of the mortgagee prevail in such a case against all other claims except those of prior encumbrancers and can be enforced notwithstanding that the principal money on the mortgage has not become due (S.73).

The mortgagee has, however, no right over the proceeds of a revenue sale if the failure to pay arrears of revenue, etc., arises from his own default.

8. Right to Compensation on Acquisition

Where the mortgaged property is compulsory acquired either under the Land Acquisition Act, 1894, or any other law, the mortgagee is entitled to claim payment of the mortgage money out of the amount due to the mortgagor as compensation for such acquisition. This claim of the mortgagee prevails against all other claims except those of prior encumbrancers and can be enforced notwithstanding that the principal money on the mortgage has not become due (S.73)

Priority

A mortgagor can always create a subsequent mortgage of the same property. In such a case what is actually mortgaged to the second or other subsequent mortgagee is the mortgagor's right of redemption. In such a case the puisne (*i.e.*, subsequent) mortgage is usually always expressed to be subject to the first or the earlier mortgage. The doctrine of priority therefore obviously has no application to such a case. The doctrine, however, applies when a mortgagor purports to create a subsequent mortgage without the existence of the earlier mortgage, or, in other words, purports to create two or more first mortgages on the same property. In such a case the rule of law is *qui prior est tempore potior est jure* (*i.e.*, he who is first in time prevails in law). Thus these successive mortgages would take priority in chronological order (S.48).

Where the earlier mortgage is by a mortgage deed, except where the principal money secured is less than Rs 100, the mortgage deed is required to be registered. Now the Transfer of Property Act makes registration of a document relating to immovable property notice of the contents of such document to all parties dealing with such property. In such a case the subsequent mortgagee has only to thank himself because the law casts on him a duty of searching the Registry. Different considerations, however, may arise when the earlier mortgage is by deposit of title-deeds and there is therefore no mortgage deed which can be registered. In such cases also the rule of law is the same subject to certain exceptions. These *exceptions* are dealt with in Sections 78 and 79.

(1) Section 78 provides that "when through (a) fraud, (b) misrepresentation, or (c) gross neglect of a prior mortgagee, another person has been induced to advance money on the security of the mortgaged property, the prior mortgage shall be postponed to the subsequent mortgage".

(2) Section 79 provides that "if a mortgage made to secure (a) future advances, (b) the performance of an engagement, or (c) the balance of a running account, expresses the maximum to be secured thereby, a subsequent mortgage of the same property shall, if made with notice of the prior mortgage, be postponed to the prior mortgage in respect of all advances and debits not exceeding the maximum though made or allowed with notice of the subsequent mortgage".

The two essential conditions for the application of the rule laid down in Section 79 are (1) the prior mortgage must express the maxi-

mum amount to be secured, if no maximum is fixed, the mortgage will not have priority as to future advances and (2) the subsequent mortgagee must have notice of the prior mortgage.

Marshalling

In the case of a sale when the owner of two or more properties mortgages them to one person and subsequently sells one or more of such properties to another person, the purchaser is entitled to have the mortgage-debt satisfied out of the property or properties not sold to him. Section 81 makes this doctrine of marshalling applicable when the subsequent transfer is by way of mortgage and not by way of sale. Thus if *A* mortgages properties *X* and *Y* to *B* and subsequently mortgages *X* to *C*, *C* is entitled to have *B*'s mortgage satisfied out of property *Y* so far as the same will extend and leave property *X* for the satisfaction of *C*'s mortgage. The principle underlying this doctrine is that it should not depend on the will of one creditor to disappoint another.¹⁴ The conditions for the application of the doctrine are —

- (1) there must be a common debtor,
- (2) there must be different debts realisable out of the several properties of that common debtor, and
- (3) such properties must be separate parcels and not fractional portions of the same property.

The doctrine can be excluded by a contract to the contrary as when the subsequent mortgage is made expressly subject to and after satisfaction of the earlier mortgage.

The doctrine also will not be applied so as to prejudice the rights of (a) the prior mortgagee, or (b) any other person who has for *consideration* acquired an interest in any of the properties.

Contribution

Where the property subject to a mortgage belongs to two or more persons having distinct and separate rights of ownership therein, the different shares in or parts of such property owned by such persons are, in the absence of a contract to the contrary, liable to contribute rateably to the debt secured by the mortgage. The value of such share or part, *i. e.* the interest of the different co-owners for the purposes of contribution, is to be determined as at the date of the mortgage in respect of which contribution is claimed, after deducting the amount of any subsequent mortgage or charge.

¹⁴ *Aldrich v. Cooper*, (1803) & Ves. 382

When one of two properties of an owner is first mortgaged to secure one debt and then both the properties are mortgaged to secure another debt, the earlier debt is to be discharged out of the first property, and the second debt to be distributed over the discharge of the first debt. (S. 82).

ILLUSTRATION

Property *X* of the value of Rs 2,000 is mortgaged to *A* for Rs 400, then property *X* and property *Y* of the value of Rs 1,600 are mortgaged to *B* for Rs 200. Subsequently *X* is sold to *C* and *Y* is sold to *D*. After payment of the first mortgage of Rs 400 to *A*, properties *X* and *Y* become equal so far as regards discharging the mortgage of *B* (i.e. by deducting Rs 400 from Rs 2,000, the original value of property *X*) and *C* and *D* will have to contribute equally to *B*'s mortgage that is Rs 1,000 each.

Contribution is a right arising between mortgagors *inter se*. It does not avail against a mortgagee who is entitled to realise his security in any manner and against any property he likes subject to the right of marshalling of a subsequent mortgagor or purchaser. A co-mortgagor cannot offer to discharge his proportionate share of the mortgage debt. If he wants to redeem the mortgage, he must redeem the whole mortgage and then sue his co-mortgagors for contribution.

The right of contribution is controlled by the right of marshalling and when there is a conflict between the two, marshalling prevails. For example, if the owner of two properties X and Y mortgages then X and

X to.....*A*
Y to.....*B*
X and *Y* to.....*C*
X to.....*D*

Y are under Section 82 (i.e. contribution) liable to contribute to *C*'s mortgage in the proportion of their values after deducting from *X* the amount of *A*'s mortgage and from *Y* the amount of *B*'s mortgage. Under Section 81 (i. e. marshalling) *D* is entitled to require *C* to proceed in the first instance against property *Y*, and not rateably as against *X* and *Y*. The person interested in the equity of redemption would probably desire *C* to proceed rateably against both properties as the effect would be to diminish *D*'s security. In such a case *D*'s right of marshalling prevails against the right of contribution.

Persons Entitled to Redeem

Any of the following persons can redeem a mortgaged property or institute a suit for its redemption—

(1) The mortgagor.

(2) Any person (other than the mortgagee of the interest to be redeemed) who has any interest in, or charge upon, the property mortgaged or the right of redemption. The interest must be a proprietary interest. (S. 91). Thus:

(a) Any of the several co-mortgagors can redeem. A co-mortgagor must, however, redeem the whole mortgage. He cannot offer to discharge the proportionate share of his liability.

(b) The landlord of the mortgagor may redeem if the tenancy is vested in him on the tenant's death without heirs. If the tenancy is subsisting a landlord has no present interest and cannot redeem.

(c) A lessee of the mortgagor has a right to redeem.

(d) A purchaser or an execution purchaser of the whole or part of the equity of redemption may redeem. As a contract to purchase property does not create any interest in property, a person who has merely contracted to purchase property or a right to redeem the same is not entitled to redeem.

(e) A puisne mortgagee, being an assignee of the equity or redemption, is entitled to redeem a prior mortgage, but not his own mortgage.

(f) A sub-mortgagee of the puisne mortgagee being an assignee of the puisne mortgagee can redeem a prior mortgage.

(g) A person holding a charge upon the property or the equity or redemption can redeem.

The section excludes a mortgagee from the category of persons entitled to redeem because the right of redemption is to be exercised against him. Though a mortgagee cannot redeem his own mortgage, a prior mortgagee who has purchased the equity of redemption stands in the shoes of the mortgagor and can redeem a puisne mortgage.¹⁵

(3) Any surety for the payment of the mortgage-debt or any part thereof (S.91).

¹⁵ *Hassambhai v. Umaji* (1903) 23 Bom. 153

(4) Any creditor of the mortgagor who has in a suit for the administration of his estate obtained a decree for sale of the mortgaged property (S. 91).

Subrogation

Subrogation means in ordinary language "substitution". Section 92 confers on persons redeeming a property subject to a mortgage a right of subrogation, that is, such person is subrogated to the rights of the mortgagee whose mortgage he redeems.

Section 92 deals with two types of subrogation, *viz.*,

- (1) legal subrogation or subrogation by operation of law and
- (2) conventional or consensual subrogation.

Legal Subrogation

The right of legal subrogation is available to—

(1) any person who has under Section 91 a right to redeem a mortgaged property or bring a suit for its redemption, other than a mortgagor, and

(2) any co-mortgagor.

Any of the above-mentioned persons on redeeming property subject to mortgage has so far as regards redemption, foreclosure or sale of such property, the same rights as the mortgagee whose mortgage he redeems may have against the mortgagor or any other person. Thus the encumbrance that is paid off is not extinguished but is kept alive for the benefit of the person making the payment and assigned by operation of law to such person. When a mortgagor redeems a mortgage he extinguishes that mortgage for he simply performs his own obligation and there is therefore in such a case no question of subrogation.

Conventional or Consensual Subrogation

This type of subrogation arises not by operation of law but by reason of a contract between the parties. A person who has advanced to a mortgagor money with which a mortgage has been redeemed is subrogated to the rights of the mortgagee whose mortgage has been redeemed, if the mortgagor has by a registered instrument agreed that such person shall be so subrogated. It is not sufficient that money has been advanced out of which a mortgage has been discharged. To entitle such lender to claim subrogation the mortgagor must agree in writing that the lender would be so subrogated. Further, such instrument or agreement must be registered.

No person can claim a right of subrogation, whether legal or conventional, unless the mortgage in respect of which the right is claimed has been redeemed in full. In other words, there can be no partial subrogation.

Prohibiting of Tacking

The doctrine of tacking applied in England until it was abolished as from 1st January 1926 by the Law of Property Act, 1925. If *A*, the owner of a property creates—

a first mortgage to *B*
 a second mortgage to *C*
 a third mortgage to *D*

Then *D* may redeem *B* and be subrogated to the right of *B*. As regards *C* he will have priority so far as *B*'s mortgage which has been redeemed is concerned and not with regard to his own mortgage. Under the old English doctrine of tacking he would have priority over *C* not only in respect of *B*'s mortgage but also in respect of his own mortgage, provided *B* had a legal mortgage and *D* had no notice of *C*'s mortgage when he advanced his money to *A*. Thus in such a case *D*'s mortgage was tacked on to *B*'s mortgage and the consolidated mortgage of *B* and *D* had priority over *C*'s mortgage. The reason for this rule was the preference allowed in equity to the legal estate. In the illustration given above the first mortgagee *B* had the legal estate. If *D* had advanced the money for mortgagee to himself without notice of *C*'s mortgage then he had an equal equity, with *C*. Now by being subrogated to *B*'s right and obtaining *B*'s legal estate, he attracted the application of the maxim of equity that "where there is equal equity, the law shall prevail". He could thus unite the mortgages, *viz.*, *B*'s and his own and thereby squeeze out the intermediate mortgagee.

In *India* Section 93 prohibits tacking. Section 93 provides that "No mortgagee paying off a prior mortgage, whether with or without notice of an intermediate mortgage, shall thereby acquire any priority in respect of his original security; and except in the case provided for by Section 79, no mortgagee making a subsequent advance to the mortgagor whether with or without notice of an intermediate mortgage, shall thereby acquire any priority in respect of his security for such subsequent advance".

In Indian Law, therefore, in the illustration given above, *D* would get as he also does in England now after January 1, 1926 priority over *C* only in respect of *B*'s mortgage and not in respect of his

own mortgage. An apparent exception in the prohibition of tacking is made in respect of cases contemplated by Section 79, that is, where a mortgage is made to secure future advances upto a fixed maximum limit there is priority for all advances upto that limit.

“Redeem Up” and “Foreclose Down”

This familiar rule of the law of mortgages is to be found in Section 91(a) and 94. Section 91(a) gives a puisne mortgagee a right to redeem a prior mortgage, *i.e.*, “redeem up”. Section 94 confers upon a prior mortgagee the same rights against a mortgagee posterior to himself as he has against the mortgagor, *i.e.*, “foreclose down”.

Once an owner of a property creates a first mortgage all that remains with the mortgagor is his right of redemption. Now as the right or equity of redemption is immovable property, it can be mortgaged. Thus a subsequent mortgage is in effect a mortgage of the equity of redemption. Therefore, under Section 91(a) a subsequent mortgagee has the right to redeem a prior mortgagee just as the original mortgagor has and in such case he becomes subrogated to the position on the prior mortgagee he redeems. In this way every puisne mortgagee can go on redeeming the prior mortgages one by one until he becomes himself the first mortgagee. This is the first part of the rule, *viz.*, “redeem up”.

Now a first mortgage has a right as against the mortgagor to foreclose or sell the property. Where there are successive mortgages, which are, as we have seen, merely transfers or assignments of the equity of redemption, a first mortgagee can foreclose all or any of the mortgages subsequent to him as he could the original mortgagor. This is the second part of the rule; *viz.*, “foreclose down”.

If <i>A</i> the owner of a property first mortgages to	<i>B</i>
then	„
then	„ <i>C</i>
and then	„ <i>D</i>
	„ <i>E</i>

E can then redeem *D*, then *C* and then *B* and become the first mortgagee, *B* can on the other hand foreclose or bring to sale *A* and as transferee of *A*'s equity of redemption also *C*, *D* and *E*.

Now if *D* wants to get in the absolute estate himself, he must not only redeem *C* and then *B*, but must also foreclose *E*, otherwise *E* might redeeming *D* defeat *D*'s purpose.

Mortgage of Movables

As we have just seen, the Transfer of Property Act provides for mortgages of immovable property, and in an earlier chapter we learnt that the Indian Contract Act provides for pledges of movable property. Thus neither of these Acts provides for a mortgage of moveable property.

In India, the mortgage of chattels has the effect of immediately transferring the property thereunder from the mortgagor to the mortgagee and can be made by mere parole and without the transfer of possession.¹⁶ It will thus be seen that the mortgage of movable property can be made in India *without a writing or a transfer* of possession and thus forms a very simple transaction unattended by the various legal formalities so familiar to the mortgage of immovable property. As no particular formality is required when goods mortgaged are left in the possession of the mortgagor, the mortgagor has plenty of opportunity to commit fraud on the mortgagee by either mortgaging or selling the same goods to someone else who is unaware of the first mortgage. In the words of Beaman, J. in the above-mentioned case, “.....the law of hypothecation or mortgage of movables is in need of radical reform”. This law, it is to be observed has been transferred bodily from England to India as part of the old common law, and must therefore, be administered here as it was in England before public policy required its correction and curtailment by the various Bills of Sales Acts. There are no such Acts in this country, and, in my opinion, we should be much better without them, provided that it was legislatively enacted that no Court should recognize any mortgages of movables for a less sum than Rs 5,000 unless evidenced by a registered writing. That would suffice to meet the legitimate exigencies of trade; and smaller loans upon the hypothecation of chattels, special or general, should, I think, be ignored unless they fulfil all the requirements of a pledge. In this country we have a very precise and easily administered law of pledge. Where money is really advanced upon a chattel and the property in the chattel thereupon passes to the creditor it is only right that he should take possession of it and so prevent other people lending money to his debtor on the faith of his being the ostensible owner of goods which really do not belong to him”. There can also be a mortgage of movable property which is *to come into existence in the future*. For example, a mortgage of future crops.

¹⁶ *Tehilram Girdharidas v. Longin D' Mello*, 8 Bom. L.R. 587

CHARGES

Where immovable property of one person is by act of parties or operation of law made security for the payment of money to another and the transaction does not amount to a mortgage, the latter person is said to have a charge on the property (S. 100).

A charge can thus be created in two ways, namely (1) by *act of parties*, or (2) by *operation of law*, e.g; the charge of an unpaid vendor for the balance of the purchase price on the property sold. A charges holder has the same right in respect of the property charged to him as a simple mortgagee has in respect of his mortgage; that is a charge-holder can (1) realise his security by bringing the property to sale through a Court or (2) sue the person creating the charge on his personal covenant to repay.

Distinction between Mortgage and Charge

(1) Although a mortgage resembles a charge in this respect that both are security payment, a mortgage is a security for the payment of a debt while a charge is a security for the payment of money which may or may not be a debt. Thus the creation of charge does not necessarily imply the existence of a debt as the creation of a mortgage does.

(2) A mortgage may be security for the performance of an engagement giving rise to a pecuniary liability but a charge is security only for the payment of money.

(3) A mortgage operates to transfer to the mortgagee an interest in the specific immovable property which is the subject-matter of the mortgage. A charge, on the other hand, does not operate to transfer to the charge-holder any interest in the property on which the charge has been created. It merely gives the charge-holder the right to have his claim satisfied out of a particular property without transferring any interest in that property to him.

(4) A mortgage gives rise to a right *in rem*. A Charge on the other hand, is available only against certain persons, namely, persons who are affected with notice of the charge. Therefore, unlike a mortgagee a charge-holder cannot follow the property in the hands of a *bona fide* purchaser for value without notice.

(5) A mortgage can only be created by act of parties. A charge may arise either by an act of parties or by operation of law.

(6) A mortgage is for a fixed term and redeemable, while charge may create a liability in perpetuity not capable of redemption.

SUMMARY MORTGAGES

The transfer of Property Act 1882 deals with Mortgages of immovable property.

What is a "Mortgage"

A mortgage is the transfer of an interest in specific immovable property for the purpose of securing the payment of money advanced or to be advanced by way of loan, an existing or future debt or the performance of an engagement which may give rise to a pecuniary liability [S. 58 (a)].

Essentials of a Valid Mortgage

- (1) There must be a transfer.
- (2) The transfer must be of an interest.
- (3) The interest transferred must be in specific immovable property.
- (4) There must be a mortgagor, *i.e.* the transferor and a mortgagee, *i.e.* the transferee.
- (5) The purpose or object of such transfer must be to secure a debt.

Classification of Mortgages: The Transfer of Property Act enumerates six kinds of mortgages, namely—

- (1) Simple mortgage.
- (2) Mortgage by conditional sale.
- (3) Usufructuary mortgage.
- (4) English mortgage.
- (5) Equitable mortgage, and
- (6) Anomalous mortgage.

Essentials of a Simple Mortgage

- (1) A personal obligation on the part of the mortgagee to pay the mortgage-money.
- (2) The transfer to the mortgagee expressly or impliedly of the right to "cause the property to be sold" in the event of the mortgagor failing to pay according to the contract.

Essentials of a Mortgage by Conditional Sale

- (1) It is an ostensible sale and not a real sale.
- (2) Such ostensible sale is subject to a condition.

(3) In default of payment the ostensible sale ripens into a real sale.

(4) On payment the mortgagee has to re-transfer the property to the mortgagor.

(5) The mortgagor does not undertake any personal liability as in the case of a simple mortgage.

(6) It is a non-possessory mortgage, *i.e.* possession of the property mortgaged is not delivered to the mortgagee.

(7) The condition must be embodied in the very same document which effects or purports to effect the sale.

(8) The remedy of a mortgagee by conditional sale is by foreclosure only and not by sale.

Essentials of a Usufructuary Mortgage

(1) It is a possessory mortgage, *i.e.* the mortgagee is put in possession of the mortgaged property.

(2) The mortgagee has a right to enjoy the rents and profits until that debt is paid.

The rents and profits or part of the rents and profits may be appropriated—

- (i) in lieu of interest,
- (ii) in lieu of principal,
- (iii) in lieu of principal and interest.

In the first case a mortgagee is not required to keep accounts (See S. 77); in the other two cases an account is necessary.

(3) There is no personal liability on the mortgagor.

(4) There is no time-limit fixed: the mortgagee remains in possession until the debt is repaid.

(5) The remedy of an usufructuary mortgagee is to continue in possession and enjoyment until the debt is repaid. A usufructuary mortgagee cannot bring a suit for foreclosure or sale (S. 67). If, however, the mortgagor fails to bring a suit for redemption within 60 years, the mortgagee becomes the absolute owner of the property.

Essentials of an English Mortgage

(1) The mortgagor should bind himself to repay the mortgage-money on a certain day, *i.e.* there should be a personal covenant to pay.

(2) The property mortgaged should be transferred absolutely to the mortgagee.

(3) Such transfer should be subject to a proviso that the mortgagee would re-transfer the property to the mortgagor upon the mortgagor making payment of the mortgage-money as agreed.

English Mortgage and Simple Mortgage Distinguished

(1) In both there is a personal covenant to pay on the part of the mortgagor.

(2) The remedy by foreclosure is not available in both.

(3) In an English mortgage the mortgagee being in the nature of an owner of the property has the right to enter into immediate possession, unless this right has been contracted against. In a simple mortgage there is no such implication of ownership and no right to take possession.

(4) Though the remedy of both is by sale, an English mortgagee has a right under certain circumstances to sell without the intervention of the Court. A simple mortgagee never has that right.

English Mortgage and Mortgage by Conditional Sale Distinguished

(1) In an English mortgage there is a personal covenant to pay on the part of the mortgagor. There is no such personal covenant in a mortgage by conditional sale.

(2) In an English mortgage the mortgagee is entitled to enter into immediate possession of the property mortgaged. A mortgagee by conditional sale has no right to enter into possession.

(3) The remedy of an English mortgagee is by sale. The remedy of a mortgagee by conditional sale is by foreclosure.

Essentials of a Mortgage by Deposit of Title-Deeds

(1) A debt.

(2) Delivery of the title-deeds to the creditor or his agent.

(3) An intention to create a security on the debt.

Effect of Mortgage by deposit of Title-Deeds: A mortgage by deposit of title-deeds prevails against a subsequent registered mortgage of the same property.

Anomalous Mortgage: A mortgage which is not a simple mortgage, a mortgage by conditional sale, an usufructuary mortgage, an English mortgage or a mortgage by deposit of title-deeds is called an anomalous mortgage [S.58(g)].

Mode of Transfer

(1) A registered instrument is necessary in the case of a mortgage other than a mortgage by deposit of title-deeds, if the principal money secured is Rs 100 or upwards.

(2) The instrument must be signed by the mortgagor.

(3) Attested by at least two witnesses and registered.

If the principal money secured is less than Rs 100 a mortgage may be made either by a registered instrument or by delivery of possession.

Effect of Non-Registration: The mortgage is void but—

(1) the instrument may be used to establish a personal covenant to pay and

(2) if possession has been delivered under it, the doctrine of part-performance may be applied.

Rights of the mortgagor

(1) Redemption.

(2) To compel the mortgagee to transfer to third persons instead of re-transference to the mortgagor.

(3) To inspect and make copies of all documents of title which are in the mortgagee's custody or power (S.60B).

The above three rights are indefeasible statutory rights and cannot be taken away from any mortgagor by any contract. A mortgagor may, however, contract himself out of any or all of the other rights enumerated below—

(4) To redeem one of two properties mortgaged to the same mortgagee and thereby avoid "consolidation" by the mortgagee of two separate mortgages (S.61).

"Consolidation" refers to the mortgagee's power to compel the mortgagor to redeem all the securities in favour of the same mortgagee or to prevent him from redeeming some without redeeming all.

(5) To recover possession of the property as well as of the mortgage deed and all documents relating thereto in case of a usufructuary mortgage (a) where the mortgage debt is sent only by usufruct or (b) where the mortgagor pays or tenders the mortgage money on or after it has become due (S.62).

(6) To get all accession to the property during the continuance of the mortgage.

(7) To all improvements made by the mortgagee to mortgaged property (S.63A).

(8) To grant a lease of the mortgaged property (S.63A).

Liabilities of Mortgagor

(1) Implied liabilities which may be varied by a special contract to the contrary (S 65).

(2) Liability for active waste which obligation cannot be removed by a contract to the contrary (S.66).

Implied Contracts by Mortgagor

(1) A warranty of title.

(2) A covenant to indemnify the mortgagee against all expenses for protecting his title.

(3) An agreement to pay all public charges during the time the mortgagor is in possession.

(4) An agreement, in case the mortgaged property is a lease, that the mortgagor has up to the time of the mortgage paid all the rents and performed all the conditions in the lease and that he will continue to do so and in case of default will indemnify the mortgage against all claims arising therefrom.

(5) An undertaking that the mortgagor will pay regularly the interests on all prior mortgages from time to time as well as the principal money when it becomes due.

The benefit of all the above mentioned implied covenants runs with the land but not the burden. Thus the assignee of the mortgagee is entitled to such benefits but the burden remains with the mortgagor alone and does not pass to a purchaser of the equity of redemption.

Rights of the Mortgagee

1. Right to foreclosure.
2. Right of suit for sale.
3. Right to sue for mortgage money.
4. Right to sell without Court's Intervention.
5. Right to spend money (S.72).

(a) for the preservation of mortgaged property from destruction, forfeiture or sale when the mortgagor has been called upon and has failed to take proper and timely steps to preserve the property;

(b) for supporting the mortgagor's title to the mortgaged property when the mortgagor has been called upon and has failed to take proper and timely steps to support his title;

(c) for making his own title good against the mortgagor; and

(d) when the mortgaged property is a renewable lease hold for the renewal of the lease.

6. Right to insure the property (S. 72).

A mortgagee is not entitled to insure—

- (a) if there is a contract to the contrary, or
- (b) if the necessary insurance is kept up by or on behalf of the mortgagor.

7. Right to proceeds of revenue sale (S.73).

8. Right to Compensation on Acquisition (S. 73).

Priority: The doctrine of priority applies when a mortgagor purports to create a subsequent mortgage without disclosing to the subsequent mortgagee the existence of the earlier mortgage, or, in other words, purports to create two or more first mortgages on the same property. In such a case the rule of law is *qui prior est tempore potior est jure* (i.e. he who is first in time prevails in law). Thus these successive mortgages take priority in chronological order.

Marshalling (S. 81): If the owner of two or more properties mortgages them to one person and subsequently mortgages one or more of such properties to another person, the subsequent mortgagee is, in the absence of a contract to the contrary, entitled to have the mortgage-debt satisfied out of the property or properties not mortgaged to him.

The conditions for the application of the doctrine are—

- (1) there must be a common debtor;
- (2) there must be different debts realisable out of the several properties of that common debtor; and
- (3) such properties must be separate parcels and not fractional portions of the same property.

The doctrine can be excluded by a contract to the contrary as when the subsequent mortgage is made expressly subject to and after satisfaction of the earlier mortgage.

The doctrine also will not be applied so as to prejudice the rights of—

- (a) the prior mortgagee; or
- (b) any other person who has for consideration acquired as interest in any of the properties.

Contribution (S. 82): Where the property subject to a mortgage belongs to two or more persons having distinct and separate rights of ownership therein, the different shares in or parts of such property owned by such persons are, in the absence of a contract to the contrary, liable to contribute rateably to the debt secured by the mortgage.

Contribution is a right arising between mortgagors *inter se*. The right of contribution is not available when there is a contract to the contrary. It is controlled by the right of marshalling and when there is conflict between the two, marshalling prevails.

Person Entitled to Redeem (S. 91)

- (1) The mortgagor.
- (2) Any person (other than the mortgagee of the interest to be redeemed) who has any proprietary interest in, or charge upon, the property mortgaged or the right of redemption. Thus:
 - (a) Any of the several co-mortgagors can redeem. A co-mortgagor must, however, redeem the whole mortgage. He cannot offer to discharge the proportionate share of his liability.
 - (b) The landlord of the mortgagor may redeem if the tenancy is vested in him on the tenant's death without heirs. If the tenancy is subsisting a landlord has no present interest and cannot redeem.

(c) A lessee of the mortgagor has a right to redeem.

(d) A purchaser or an execution purchaser of the whole or part of the equity redemption may redeem. As a contract to purchase property does not create any interest in property, a person who has merely contracted to purchase property or a right to redeem the same is not entitled to redeem.

(e) A puisne mortgagee, being an assignee of the equity of redemption, is entitled to redeem a prior mortgage, but not his own mortgage.

(f) A sub-mortgagee of the puisne mortgagee being an assignee of the puisne mortgagee can redeem a prior mortgage.

(g) A person holding a charge upon the property or the equity of redemption can redeem.

(3) Any surety for the payment of the mortgage debt or any part thereof.

(4) Any creditor of the mortgagor who has in a suit for the administration of his estate obtained a decree for sale of the mortgaged property.

Subrogation (S. 92): Persons redeeming a property subject to a mortgage are subrogated to the rights of the mortgagee whose mortgage they redeem.

(1) Legal Subrogation

The right of legal subrogation is available to -

(1) any person who has under Section 91 a right to redeem a mortgaged property or bring a suit for its redemption, other than a mortgagor, and

(2) any co-mortgagor.

(2) Conventional or Consensual Subrogation

This type of subrogation arises not by operation of law but by reason of a contract between the parties. A person who has advanced to mortgagor money with which a mortgage has been redeemed is subrogated to the rights of the mortgagee whose mortgage has been redeemed, if the mortgagor has by a registered instrument agreed that such person shall be so subrogated. There can be no partial subrogation.

Prohibition of Tacking (S. 93): In India tacking is prohibited.

“Redeem Up” and “Foreclose Down”. A *puisne* mortgagee has a right to redeem a prior mortgage *i.e.* “redeem up”. A prior mortgagee has the same rights against mortgagees posterior to himself as he has against the mortgagor, *i.e.* “foreclose down”.

If A the owner of a property first mortgages to.....	B
thenC
thenD
and thenE

E can then redeem *D*, then *C* and then *B* and become the first mortgagee. *B* can on the other hand foreclose or bring to sale *A* and as transferee of *A*'s equity of redemption also *C*, *D* and *E*.

Now if *D* wants to get in the absolute estate himself, he must not only redeem *C* and then *B*, but must also foreclose *E*, otherwise *E* might by redeeming *D* defeat *D*'s purpose.

CHARGES

Where immovable property of one person is by act of parties or operation of law made security for the payment of money to another and the transaction does not amount to a mortgage, the latter person is said to have a charge on the property (S. 100).

A charge can thus be created—

- (1) by act of parties, or
- (2) by operation of law,

A charge-holder can realise his security by bringing the property to sale through a court.

Distinction between Mortgage and Charge

(1) A mortgage is a security for the payment of a debt while a charge is a security for the payment of money which may or may not be a debt.

(2) A mortgage may be security for the performance of an engagement giving rise to a pecuniary liability but a charge is security only for the payment of money.

(3) A mortgage operates to transfer to the mortgagee an interest in the specific immovable property which is the subject-matter of the mortgage. A charge, does not operate to transfer to the charge-holder any interest in the property on which the charge has been created. It merely gives the charge-holder the right to have his claim satisfied out of a particular property without transferring any interest in that property to him.

(4) A mortgage gives rise to a right *in rem*. A charge is available only against certain persons, namely, persons who are affected with notice of the charge. Therefore, unlike a mortgagee a charge-holder cannot follow the property in the hands of a *bona fide* purchaser for value without notice.

(5) A mortgage can only be created by act of parties. A charge may arise either by an act of parties or by operation of law.

(6) A mortgage is for a fixed term and redeemable charge may create a liability in perpetuity not capable of redemption.

TYPICAL QUESTIONS

1. (a) Discuss from the point of view of a banking company the merits and demerits of a mortgage by deposit of title deeds as against an English mortgage, where the borrower is a company.
- (b) Discuss the order of priority among the following:—
 - [i] a mortgage by deposit of title deeds made at Bombay on the 3rd January 1971;
 - [ii] A simple mortgage executed on the 12th February 1971, presented on the same date for registration and registered on the 10th November 1971, the mortgagee having knowledge of the mortgage by deposit of title deeds; and
 - [iii] an English mortgage executed on the 10th January 1971, presented on the same date for registration and registered on the 20th December, 1971, the mortgagee having no knowledge of the mortgage by deposit of title deeds.

All the three mortgages related to the same property.

2. (a) *M*, who owns some lands situated in a village in a district in Maharashtra delivers in Bombay city to a bank there the documents of title relating to the lands and borrows money from the bank on the security of the lands. Does the bank get a good mortgage over the lands?
- (b) *X* executed a registered mortgage in favour of *Y* for Rs 50,000 to be advanced from time to time; and immediately borrowed Rs 10,000. Subsequently *Z*, who knew of this mortgage, lent to *X* Rs 20,000 on mortgage of the same property. Again, *Y*, knowing of the mortgage to *Z*, lent Rs 15,000 under the mortgage in his favour. *Z* brought the property to sale in execution of a decree against *X* and realised Rs 35,000. How is this sum to be distributed between *Y* and *Z*?
- (c) *P* executed a registered mortgage in favour of *Q* on 16th May 1969 but the mortgage was registered by the Registrar on 10th March 1970. On 7th October 1969 *P* executed a mortgage by deposit of title deeds over the same property in favour of *R* and on 8th February 1970 he executed another registered mortgage over the same property in favour of *R*. How do the three mortgages rank for priority among themselves?
3. (a) State and explain briefly the main elements of a simple mortgage and an English mortgage.
- (b) In what cases can a mortgagee sell the mortgaged property without the intervention of a Court?
- (c) As between a mortgage by deposit of title-deeds made in January 1970 and a simple registered mortgage executed on the 15th December 1969 and registered on the 12th December 1970, how would you assess priority?
- (d) State briefly, and referring to any time limits applicable, the steps in the procedure for effecting registration of a simple mortgage executed by an individual on the 1st April 1971.

4. What is the "right of private sale" of a mortgagee? In what cases can it be exercised, and subject to what conditions?

5 Distinguish a charge from the simple mortgage?

6. Under what circumstances can a mortgaged property be sold without the intervention of the Court?

7. (a) Define a mortgage and state the ingredients of the various types of mortgages referred to in Section 58 of the Transfer of Property Act, 1882.

(c) Who are entitled to redeem a mortgage?

8. On 12th March 1965 *A* executed a mortgage for Rs 6,000 in favour of *X* by depositing with *X* at Bombay title deeds relating to *A*'s property situate in an up-country village; and borrowed the said sum of that date. *A* then executed a registered mortgage of the same property in favour of *Y* on 15th August 1965 for Rs 10,000 lent by *Y* to *A* on 15th January 1965. When *Y* realised Rs 14,000 by sale of the property, *X* asked *Y* to pay him Rs 6,000 and the interest thereon due to him. How will you decide?

On 10th August 1964, *B* an individual, executed a simple mortgage for Rs 8,000 in favour of *P*; this was registered on 10th December 1964. *B* executed in favour of *Q*, another simple mortgage for Rs 12,000 on 12th September 1964 and this was registered on 12th October 1964. When *Q* realised Rs 12,000 by sale of the property in 1966, *P* asked *Q* to pay him Rs 8,000 and the interest due thereon. How will you decide?

Chapter 23

INSOLVENCY LAW

THE INDIAN insolvency law is covered by two Acts, (1) the Presidency-towns Insolvency Act of 1909, which applies to the Presidency Towns of Bombay, Madras and Calcutta, and (2) the Provincial Insolvency Act of 1920 which applies to the mofussil. Prior to these Acts the bankruptcy law of India was covered by a statute of Imperial legislation.¹ The new Acts cannot operate outside the limits of India and, therefore, the proceedings against an insolvent possessed of estates both in England and India must be concurrent in both these countries. *The Indian Act cannot vest in the official assignee the real and personal estates of the insolvent, situate outside the limits of India.*

Who can be made Insolvent

Before answering this question, it may be noted that the word 'bankrupt' means in England, a person who has committed an act of bankruptcy and who has been adjudicated a bankrupt, whereas an insolvent in English law means a person who is unable to pay his debts, i.e. whose liabilities exceed his assets. In our Indian Acts the word 'insolvent' is used throughout, as if it were synonymous with the word 'bankrupt'. It is so used because the word 'insolvent' has become quite familiar in Indian law and practice.

¹ Act 11 and 12, Vic. Ch. 21

Any person of full age and sound mind may be declared an *insolvent* under the circumstances dealt with later.

Minors: A minors cannot be made insolvent even for a debt relating to the supply of necessaries, since a minor is incapable of entering into a binding agreement. In the case of a minor admitted to the benefits of partnership only the major members of the firm can be adjudged insolvent, but the minor's interest in the partnership will vest in the official Assignee.

Lunatics: A lunatic cannot commit an act of insolvency which involves intent, therefore he cannot be adjudged an insolvent except for debts incurred and acts of insolvency committed while he was in a lucid interval, *i.e.*, while sane.

Foreigners: A foreigner can be made insolvent only if he has committed an act of insolvency while he was personally residing in India, even though he may be absent from India at the time of the presentation of the petition.

Married Women: A woman, married or single, may be made an insolvent.

Partners: As the liability of a partner for the debts of the firm is joint and several, a petition can be filed against one or more of the partners provided such partner or partners have committed an act of insolvency.

An order of adjudication can also be made against a partnership firm in which case it would operate as if it were an order against each of the partners.

Joint Hindu Family: Members of a joint Hindu family may be adjudged insolvent if they have committed an act of insolvency jointly and are personally liable on a joint debt. Where, however, the Karta carries on a joint Hindu family business, he alone being personally liable for the debts of the firm, the members cannot be adjudged an insolvent. A minor member of a joint Hindu family cannot be adjudged an insolvent.

Companies: A company registered under the Companies Act cannot be adjudged insolvent as a special procedure for winding up of companies is provided by that Act.

Jurisdiction

The Courts which exercise insolvency jurisdiction are the *High Courts* of Bombay, Madras and Calcutta in the Presidency towns, and in the mofussil the *District Courts* and such other subordinate

Courts as may be invested with insolvency jurisdiction by Government notification.

Courts which exercise insolvency jurisdiction have power, subject to the provisions of the Insolvency Acts, to decide all questions, (1) which may arise during the course of insolvency proceedings or (2) which the Court deems expedient or necessary to decide in order to do complete justice or to make a complete distribution of the property in each case.²

THE PRESIDENCY TOWNS INSOLVENCY ACT

The Petition

Proceedings in insolvency commence with the presentation of a petition. The petition may be presented either by (1) the debtor himself, or (2) by a creditor or creditors, and the Court may on such a petition make an order of adjudication by which the debtor is adjudicated an insolvent.

The Court has *jurisdiction* to make this order only where—

(1) the debtor is, at the time of the presentation of the insolvency petition, either imprisoned in execution of the decree of a Court for non-payment of money, in any prison to which debtors are ordinarily committed by the Court in the exercise of its ordinary original jurisdiction, or

(2) where within a year before the date of the presentation of the insolvency petition, the debtor has ordinarily resided, or had a dwelling house, or has carried on business in person, or through his agent, within the limits of the ordinary original civil jurisdiction of the Court; or

(3) where the debtor personally works for gain within those limits, or

(4) in the case of *petitions by or against a firm of debtors*, the firm has carried on business within a year prior to the date of presentation of the insolvency petition within those limits (S.11).

Under Section 11 of the Provincial Insolvency Act the Court also has jurisdiction where the debtor is in custody and no particular period of residing or carrying on business etc., is prescribed. Another difference in the Provincial Act is proviso to Section 11 which states that an objection to jurisdiction must be taken at the

² S.7 Presidency Towns Insolvency Act and S.4 Provincial Insolvency Act.

earliest opportunity in the court by which the petition was heard and not later in appellate or revisional jurisdiction (S.11 Prov. Act).

Creditor's Qualification

With regard to a creditor's or creditors' petition, it is further provided that the debt owing to the creditor or creditors, singly or jointly, must amount to at least Rs 500 in the aggregate, which should be a *liquidated sum* payable immediately or at some certain future time and the act of insolvency on which the petition is based should have occurred within three months immediately prior to the presentation of the petition unless the said period of three months expires on a day when the Court is closed in which case the insolvency petition may be presented on the day on which the Court reopens (S. 12).

Debtor's Qualification

A debtor will not be entitled to present an insolvency petition, unless—

- (a) his debts amount to Rs 500, or
- (b) he has been arrested and imprisoned in execution of the decree of any Court for the payment of money, or
- (c) an order of attachment in execution of such a decree has been made and is subsisting against his property, (S. 14).

Acts of Insolvency

We have noticed that *petition in insolvency can only be presented if the debtor has committed an act of insolvency*. The acts of insolvency, according to Section 9, are the following—

- (a) if, in India or elsewhere, he makes a transfer of all or substantially all his property to a third person for the benefit of his creditors generally;
- (b) if, in India or elsewhere, he makes a transfer of his property or of any part thereof with intent to defeat or delay his creditors;
- (c) if, in India or elsewhere, he makes a transfer of his property or of any part thereof, which would, under this or any other enactment for the time being in force, void as a fraudulent preference if he were adjudged an insolvent;
- (d) if, with intent to defeat or delay his creditors,
 - (i) he departs or remains out of India,

- (ii) he departs from his dwelling-house or usual place of business or otherwise absents himself,
- (iii) he secludes himself so as to deprive his creditors of the means of communicating with him;
- (e) if any of his property has been sold or attached for a period of not less than twenty-one days in execution of the decree of any Court for the payment of money;
- (f) if he petitions to be adjudged an insolvent;
- (g) if he gives notice to any of his creditors that he has suspended or that he is about to suspend payment of his debts;
- (h) If he is imprisoned in execution of the decree of any Court for the payment of money;
- (i) If, after a creditor has served an *insolvency notice* on him under this Act in respect of a *decree or an order* for the payment of any amount due to such creditor, the execution of which is not stayed, he does not, within the period specified in the notice which shall *not be less than one month*, either comply with the requirements of the notice or *satisfy* the Court that he has a counter claim or set-off which equals or exceeds the decretal amount ordered to be paid by him and which he could not lawfully set up in the suit or proceeding in which the decree or order was made against him (*Note: Clause (i) applies to Bombay only*).

Insolvency Notice

As has already been mentioned in the previous heading under clause (i), non-compliance by the debtor in Bombay with the insolvency notice served on him by his creditor would amount to an act of insolvency. Section 9A of the Act provides further in this connection and states that an insolvency notice must be given in the prescribed form and served in the prescribed manner. It must require the debtor to pay the amount due under the decree or order, or to furnish security for the payment, within the time mentioned in the notice, of such amount to the satisfaction of the creditor or to his agent, or to satisfy the Court that he has counter-claim or set-off as mentioned in clause (ii) and must also state to the effect that failure to comply with the terms of the notice would amount to act of insolvency. The notice, however, is not invalid merely because it specifies an amount exceeding the amount actually due unless the debtor gives notice of such misstatement within the time allowed for payment.

With regard to (g) the notice required by the Act must be a *written notice to suspend payment given by the debtor to his creditors.*^{*}

Order of Adjudication

On presentation of the petition either by the debtor or by the creditor, the Courts, *in India*, may proceed immediately to pass an Order of Adjudication. *In England*, however, the first step taken is to pass a Receiving Order by which the official receiver is appointed receiver of the property of the debtor, and after this order a general meeting of creditors is called to consider whether a scheme for composition can be entertained or whether the debtor should be adjudged a bankrupt. *Here*, as we have seen, *the adjudication order is passed on the petition from the very beginning*. The Court may also *reject* the petition if it is not satisfied with the proofs furnished by the creditors as to the acts of insolvency or as to the debt due to the petitioning creditors. The petition will also be *rejected* if the debtor appears and satisfies the Court that he is able to pay his debts. If the debtor does not appear after the petition is served on him, the order of adjudication will be made as a matter of course. If, however, it happens that the debtor appears and disputes the claim of his petitioning creditor, or that the claim is less than the amount which would justify the petitioner in petitioning against him, the Court may, on the deposit of security, stay all proceedings on the petition for such time as may be required for trial of the question, relating to the debt. A creditor's petition shall not, after presentation, be withdrawn without the leave of the Court (S. 13).

It is, however, open to the Court to appoint the official assignee to be *interim* receiver of the property of the debtor to take possession of it pending and before an order of adjudication, on being satisfied that such an order was necessary for the protection of his claim (S. 16).

A debtor's petition must allege that the debtor is unable to pay his debts and if the debtor proves that he is entitled to present the petition, the Court may thereupon make an order of adjudication. A debtor's petition also cannot be withdrawn without the leave of the Court. On making of the order admitting the debtor's petition, the debtor must (a) unless the Court otherwise directs produce all his books of accounts and (b) file such lists of creditors and debtors and

^{*} *Vassanji v. Mulji Ranchoddas*, 28 Bom. L.R. 677

afford such assistance to the Court as may be prescribed. If he does not do this the Court may dismiss his petition (S. 15).

Notice of the order of adjudication must be published in the Gazette of India, local Official Gazette and in any other prescribed manner giving the name, address and description of the insolvent, the date of adjudication, the Court by which the order is made and the date of the presentation of the petition.

Effect of Adjudication Order

The effect of the order of adjudication is that *all the property of the insolvent, wherever situated vests in the Official Assignee in India and trustee in bankruptcy in England for the benefit of the creditors of the debtor*. After such an order, no creditor of the insolvent can bring any suit without the leave of the Court nor can he have any remedy against the property of the insolvent during the pendency of the insolvency, as long as the creditor's debt is provable in insolvency. This rule, however, does not prevent a secured creditor from realizing or otherwise dealing with his security (S. 17).

After passing the adjudication order, the Court may *stay* any *suit* or other *proceedings* that may be *pending* against the insolvent before any Judge or Judges of the Court, or in some other Court subject to the superintendence of the Court (S. 18).

Annulment of Adjudication

In the following cases an adjudication may be annulled by the Court—

(1) If in the opinion of the Court the debtor ought not to have been adjudged insolvent (S. 21).

(2) If it is proved to the satisfaction of the Court that the debts are paid in full (S. 21).

(3) If the adjudication was on a petition presented without the Court's leave where such leave was necessary under Section 14(2) (S. 21).

(4) If it is proved to the satisfaction of the Court that insolvency proceedings are pending in any other Court in India, whether within or without the States, against the same debtor and that the property of the debtor can be more conveniently distributed by such other Court (S. 22).

(5) When the Court approves a composition or scheme of arrangement (S. 30).

(6) If the insolvent does not appear at the hearing of the application for his discharge or does not apply for his discharge within the time specified by the Court (S. 41).

(7) If insolvency proceedings are pending against the debtor in a subordinate Court, the High Court may stay proceedings at any time after the insolvency petition or at any time after the making of an adjudication order against the debtor in such subordinate Court (S. 18A).

Notice of the order of annulment must be published in the official Gazette and in any other prescribed manner.

The effect of the annulment of adjudication is that the insolvent does not get any property which has already been distributed among his creditors as under Section 23(1) all sales and dispositions of property and payments duly made and all acts theretofore done by the Official Assignee or the Court, are valid. The Court may also retain control over the debtor's property by vesting it in some other person. If, however, no such vesting order is made at the time of annulment such property automatically reverts to the ex-insolvent [S. 21 (1)]. Thus the ex-insolvent will be in the same position as if the adjudication had never taken place in the sense that the property which reverts to him is subject to his original powers and rights over it as well as to all the burdens which existed at the time of adjudication such as an attachment in execution of a decree against him. Similarly, if he was released from custody on being adjudicated, he will be liable to be re-arrested and re-committed to custody on the order being annulled.

Special Manager

It frequently happens that the nature of the debtors' estate is such that *in the interest of the creditors generally* a special manager of the estate ought to be appointed to assist the Official Assignee. On being satisfied on this point, the Court may make the appointment of a manager for any time it thinks fit, with powers to assist the Official Assignee in the work that may be assigned to him. A special manager would be required to *furnish security to keep accounts* in such manner as may be directed by the Court, and is to receive such remuneration as the Court determines (S. 19).

The Official Assignee may even appoint the insolvent himself to superintend the management of the property of the insolvent or of any part thereof, or to carry on the trade (if any) of the insolvent, for the benefit of his creditors and in any other respect to aid in ad-

ministering the property in such manner and on such terms as the Official Assignee may direct. The Court may grant an allowance out of the insolvent's property to the insolvent in consideration of his services or for the support of the insolvent and his family (S. 75).

Protected Transactions

According to Section 57 of our Presidency Towns Insolvency Act of 1909, and the corresponding Section 45 of the English Bankruptcy Act of 1914, if any of the *following transactions* take place (a) *before* the date of the order of *adjudication* (in England the Receiving Order), *and* (b) if the person, has *not*, at the time, *notice* of the *presentation* of any insolvency petition by or against the debtor, he will be protected. These transactions are—

- (1) Any payment by an insolvent *to* any of his *creditors*;
- (2) Any payment or delivery of property *to* the *insolvent*;
- (3) Any transfer by the insolvent for valuable *consideration*; or
- (4) Any contract or *dealing* by or with the insolvent for valuable consideration.

Doctrine of Relation Back

Although the property of the insolvent vests in the Official Assignee on the passing of the order of adjudication, the title of the Official Assignee as well as the insolvency, under the *Presidency Towns Insolvency Act*, commences at a much earlier date, *i e.* at the time when *the act of Insolvency was committed* on which the order of adjudication is made. If more than one act of insolvency have been committed, then the insolvency commences at the time the *earliest* of the acts of insolvency was proved to have been committed by the insolvent *within three* calendar months *preceding* the date of the *presentation* of the insolvency petition.

It should be noted that the law as to the commencement of insolvency under the English law is the same as under the Presidency Towns Insolvency Act, while under the *Provincial Insolvency Act*, the *insolvency* commences with the *presentation of the petition*, by or against the debtor, on which the order of adjudication is based. When an order of adjudication is made by reason of the doctrine of relation back, the insolvent is regarded as not having been the owner of the property as from the commencement of the insolvency. Thus transaction entered into by the insolvent from the commencement of the insolvency would be void and would not be binding on the Official Assignee. Originally the doctrine of relation back was strictly

applied and resulted in great injustice to those who dealt with the bankrupt *bonofide* without notice of an act of bankruptcy. In order to remedy this the English Bankruptcy Act introduced the "protection clause" and following this our Indian Acts included the protection sections, thus introducing the exception to the doctrine of relation back. This exception has already been explained under the heading, "Protected transactions".

In this connection it is *important* to note the *material difference* between the position at English law and that under Section 57 of our *Presidency Towns Insolvency Act*. In England law, all transactions entered into with a bankrupt between the commencement of bankruptcy and the date of the Receiving Order are protected, (1) if the person receives no notice at the time of *any available act of bankruptcy* and (2) if the transactions are *bona fide*, but those who have such a notice are prevented from entering into transactions with the bankrupt because if a petition is presented and the debtor adjudicated a bankrupt within three months, the doctrine of "relation back" will make the dealings void against the trustee in bankruptcy. In Indian law, however, all transaction between the commencement of the insolvency and the date of the order of adjudication are protected, if person had no notice at the time of the *presentation of the insolvency petition* and acts *bona fide*. In other words, *the notice of the act of insolvency in India does not deprive the person dealing with the insolvent of the protection he enjoys as it is in case of English law.*⁴

The Insolvent's Schedule

The insolvent debtor is required to prepare a schedule within 30 days of the order of adjudication, if passed on the petition of the debtor himself, or within 30 days from the date of service of the order if made on the petition of a creditor. The schedule must be prepared *in the prescribed form* verified by affidavit and if the debtor fails to do so without reasonable excuse, he is liable to be committed to civil prison (S.24)

Protection Order

After the submission of the schedule the insolvent may apply to the Court for protection, and the Court may then grant him a Protection Order on production of a certificate signed by the Official Assignee to the effect that he has so far conformed to the provisions of the Act.

⁴ *Bhagwandas & Co. v. Chuttan Law* (1921), 43 All. 427; *Mercantile Bank of India Ltd. v. Official Assignee, Madras* (1916), 39 Mad. 250.

A Protection Order is an order of the Court by which *the insolvent is protected from being arrested or detained in prison for any debt to which the order shall apply* and in case the insolvent is already under arrest or detention he may be entitled to be released. *The idea of this order* is that the insolvent debtor should not be harassed by the execution creditors during the time that his affairs in insolvency are under investigation, provided the insolvent performs his duties as prescribed by the Act.

The protection order may apply either to all the debts mentioned in the Schedule or to any of them as the Court may think proper. The Court may also direct as to the time from which it is to commence and take effect and the Court may revoke or renew such order. Any creditor can appear and oppose the grant of the order. However, the insolvent is *prima facie* entitled to such order on production of a certificate signed by the Official Assignee that the insolvent has so far conformed to the provisions of this Act. The Court may, at its discretion, make the protection order even before the insolvent has submitted his schedule, if it thinks necessary to do so in the interests of the creditors (S.25).

Composition of Schemes of Arrangement

After an adjudication order is made, an insolvent may propose a scheme of composition, or submit a proposal for a scheme of arrangement which scheme shall be submitted by the Official Assignee to a meeting of creditors. Both under the Presidency as well as the Provincial Acts the proposal can only be submitted by the debtor *after* adjudication, whereas under the *English Act* a proposal for a composition or scheme can be submitted after a receiving order or after adjudication. A copy of the scheme or proposal is to be sent to each creditor mentioned in the schedule or to those who have tendered a proof of their claim before the meeting, and if on consideration of the debtor's proposal the *majority in number and three fourths in value* of all the creditors whose debts are proved resolve to accept the proposal, the scheme will be taken to have been duly accepted by the creditors. Any creditor may accept or refuses to accept the scheme by a letter addressed to the Official Assignee to reach him before the day of the meeting, which act would be construed to be as good as his having attended and voted at the meeting (S 28). *The Official Assignee or the insolvent should then apply to the Court to approve the scheme*, notifying all the creditors of the time and day on which such an application is to be made. Any creditor who has proved his debt may oppose the scheme of composition even

though he may have voted in favour of the proposition at the meeting. The Court would hear the report of the Official Assignee as to the terms of the composition and conduct of the insolvent and then *accept or approve* the scheme in case *it appears to the Court reasonable and calculated to benefit the general body of the creditors*, otherwise it would reject the same. Where the Court finds that certain circumstances have transpired which compel the Court to refuse the insolvent's discharge, or to suspend or attach conditions to it, the Court will refuse to approve the proposal unless at least four annas in the rupee on all the unsecured debts against the debtor's estate are provided for by securities (S.29). On approving the scheme, the Court would make *an order annulling adjudication*. On such an approval the composition scheme shall be binding on all creditors, so far as it relates to debts to them from the insolvent which are provable in insolvency (S.30).

Annulment of Composition or Scheme

The composition or scheme of arrangement may be annulled by the Court under any of the following circumstances—

- (1) Where any instalment due on the scheme is not paid; or
- (2) where the Court is of opinion that the scheme cannot proceed without injustice or undue delay; or
- (3) if the Court finds that its approval was obtained by fraud.

The affect of such an order is that the debtor is readjudged insolvent and his property once again vests in the Official Assignee, but, of course, without prejudice to the validity of any transfer or payment duly made in pursuance of the composition or the scheme. All debts provable in other respects which have been contracted before the date of such re-adjudication shall be provable in insolvency (S. 31).

It may be added here that the approval of the composition or scheme will not be binding on any creditor whose debt is of such a nature as would not be discharged by an order of discharge unless the creditor assents to the composition or scheme (S. 32).

Debts not Wiped off by Discharge or Composition

The following are the debts which do not discharge an insolvent either by an order of discharge or by the approval of the composition or scheme by the Court—

- (a) Any debt due to the Government;

(b) any debt or liability incurred by means of any fraud or fraudulent breach of trust to which the debtor was a party;

(c) any debt or liability in respect of which the debtor has obtained forbearance by any fraud to which he was a party; or

(d) any liability under an order for maintenance made under Section 488 of the Code of Criminal Procedure, 1898 (S. 45).

Duties of the Insolvent

The duties of the insolvent are clearly laid down in Section 35. They are as follows—

(1) To attend any meeting of creditors which the official assignee may require him to attend, unless prevented by sickness or other sufficient cause and to give such information and submit to such examination as the meeting may require.

(2) The insolvent shall—

(a) give such inventory of his property, such list of his creditors and debtors and of the debts due to and from them, respectively;

(b) submit to such examination in respect of his property of his creditors;

(c) wait at such times and places on the official assignee or special manager;

(d) execute such powers-of-attorney, transfers and instruments; and

(e) generally do all such acts and things in relation to his property and distribution of the proceeds amongst his creditors

as may be required by the official assignee or special manager or may be prescribed or be directed by the Court by any special order or orders made in reference to any particular case, or made on the occasion of any special application by the official assignee or special manager, or any creditor or person interested.

(3) The insolvent shall aid, to the utmost of his power, in the realization of his property and the distribution of the proceeds among his creditors.

(4) If the insolvent wilfully fails to perform the duties imposed upon him by this section, or to deliver up possession to the official assignee of any part of his property, which is divisible amongst his creditors under this Act, and which is for the time being in his possession or under his control, he shall, in addition to any other

punishment to which he may be subject to be guilty of a contempt of Court, and may be punished accordingly (S. 33).

DEBTOR'S PROPERTY

"*Property*", according to the Insolvency Act, "includes any property over which or over the profits of which any person has a disposing power which he may exercise for his own benefit" [S. 2 (e)].

The property of the insolvent which is divisible among his creditors *does not include*—

- (1) property held by the insolvent in *trust* for any other person,
- (2) the tools, if any, of his trade, and the necessary wearing apparel, bedding, cooking-vessels and furniture of himself, his wife and children, to a value, inclusive of tools and apparel and other necessities as aforesaid not exceeding Rs 300 in the whole [S. 52 (1)].

The property held in trust which is not divisible among the creditors includes property held by the debtors in any fiduciary capacity such as executor or administrator, factor, broker, auctioneer, etc.

Where any part of the property of the insolvent consists of stock, shares in ships, shares or any other property transferable in the books of any company, office or person, the Official Assignee may exercise the right to transfer the property in the same manner as the insolvent may have done. Besides this, all the property of the insolvent which consists of things in action shall also be deemed to have been duly transferred to the Official Assignee. Also any banker, agent or attorney of the insolvent or any other officer who may have any money or securities in his possession belonging to the insolvent shall hand them over to the Official Assignee unless he has by law the power to retain them against the Official Assignee. If he fails to do so he will be guilty of a *contempt of Court* (S. 58). The act also gives power to the Court to grant a *warrant for the searching of any building or room where any property belonging to the insolvent is supposed to be concealed* (S. 59).

With regard to an officer of the Indian Army or Navy, or an officer or clerk or otherwise employed or engaged in the civil service of the Government the Official Assignee shall have the right to receive for distribution among creditors so much of the insolvent's pay or salary which is liable to attachment in execution of a decree as the Court may direct (S. 60).

Reputed Ownership

In this connection it should be noted that *the doctrine of reputed ownership applies only to traders*. It aims at the protection of the general creditors of a trader against their having given false credit through relying on the goods which are in the possession of the debtor and under his order and disposition which do not belong to him in fact, but which ostensibly appear to be his property.⁶ Thus, not only the goods actually belonging to the insolvent trader, but also those which happen to be under his "order and disposition" vest in the official assignee or receiver. The requisites in case of reputed ownership happen to be that.—

(1) the property must be goods,

(2) the goods must be in the possession, order or disposition of the insolvent, in his trade or business at the commencement of the insolvency and under such circumstances that is a reputed owner.

(3) the true owner should have consented to such possession of the goods by the insolvent in his trade or business and under such circumstances that he is the apparent reputed owner thereof.

Cases where the question of reputed ownership may arise include instances of goods being left with the seller after payment by the buyer, goods being sent to a shop for sale, mortgaged goods remaining in the possession of the mortgagor etc. The reason here is that as the true owner allows the goods to be in a shop where goods are normally sold, innocent third parties would naturally infer that the goods belong to the owner of the shop. It should be noted that the Provincial Act differs in this regard as there the doctrine of reputed ownership does not apply to goods which have been mortgaged or hypothecated and therefore the Official Receiver takes the goods subject to the mortgage or hypothecation.

After-acquired Property

We have already seen above that the property acquired by or devolving on the insolvent after adjudication also vests in the Official Assignee, but not unless and until this officer intervenes on behalf of the insolvent's estate. If he does not intervene and meanwhile the insolvent transfers his property to another who takes it in good faith and for value, the transferee acquires a good title to it. The same rule applies to the trustee in bankruptcy in England, under their Bankruptcy Act. Wages earned by the bankrupt after adjudication, by his own personal exertion or labour, also do not pass to the

⁶ *Ryall Rowles* (1750), 1 Ves. Sen., 348

official assignee or trustee, i.e. at least such part of them, as are deemed necessary for the support himself and his family. This rule is laid down in the English case of *Cohen v. Mitchell*⁶. This case has been followed in India in *Chhote v. Kader Nath*.⁷ This rule applies to all after acquired "choses in action" such as legacy, interest acquired after bankruptcy, in trust funds settled before bankruptcy as well as to after acquired leaseholds. There is some conflict in opinion as to whether this rule in *Cohen Mitchell* applies to immovable property in India. The exact wording of the rule is as follows —

"Until the trustee intervenes all transactions by a bankrupt after his bankruptcy with any person dealing with him *bona fide* and for value in respect of his after-acquired property, whether with or without knowledge of his bankruptcy, are valid against the trustee."

This rule applies to all transactions entered into with the bankrupt and not only to assignment or subsequent negotiations in trade made in favour of trade creditors.⁸

There is a difference in the Provincial Insolvency Act, under which after-acquired property vests in the Official Receiver as from the date of the acquisition or devolution as the word "forthwith" occurs in Section 28 of the Provincial Act, "all property acquired by the insolvent after adjudication and before discharge shall *forthwith* vest in the Receiver". Thus the rule in *Cohen v. Mitchell* does not apply to the Provincial Act. As the word "forthwith" does not occur in the Presidency Act the vesting is postponed until the trustee intervenes and thus until then the insolvent can deal with such property and give a good title to *bona fide* transferees for value.

Debtor's Property in a Foreign State

Debtor's property in a Foreign State is not included in the property which vests in the Official Assignee. Although the Presidency Towns Insolvency Act, 1909, talks of property of the insolvent "wherever situate" it does not include property situate outside India. In other words, *only property situated within India will vest in the Official Assignee*. In a Bombay case an insolvent had obtained discharge in Bombay. One of his creditors in Bombay filed a suit against the insolvent in a Foreign State where he had property. The insolvent applied to the Bombay Court to restrain the creditor from doing so as the insolvent was discharged by the Bombay Court with respect to all debts including the debt due to this particular

⁶ (1890), 25 Q.B.D., 262 on page 267

⁷ (1924), 46 All. 565

⁸ *Ali Muhammad v. Vadilal* (1919), 43 Bom. 890.

creditor. The Court refused on the ground that it had no jurisdiction to do so.⁹

ONEROUS PROPERTY

Under this heading are placed land of any tenure burdened with onerous conditions, shares and stocks in companies, unprofitable contracts, or any other property which is unsaleable or not readily saleable because of its binding the possessor to the performance of any onerous action or to the payment of any sum of money. In case of such property of the insolvent, *the Official Assignee is given the option to disclaim in writing signed by him within twelve months after the adjudication of the insolvent*. This power of disclaimer may be exercised by the Official Assignee notwithstanding the fact that he may have endeavoured to sell or may have taken possession of the property or may have exercised any act of ownership in relation thereto [S.62(1)]. If, however, an *application in writing* has been made to the Official Assignee by any person interested in the property requiring him to decide whether he will disclaim, and the Official Assignee has declined or neglected to give notice that he disclaims within twenty-eight days after the receipt of application or such extended period as may be allowed by the Court, the Official Assignee shall not be entitled to disclaim the property thereafter and he shall be taken to have adopted it (S.64). *In the case of leasehold property*, the Official Assignee is not entitled to disclaim without the leave of the Court. Before granting such leave the Court may require such notices to be given to persons interested as it may think just (S.63). *Any person injured by the operation of a disclaimer will be deemed to be a creditor of the insolvent to the extent of the amount of the injury and may prove it as a debt under the insolvency* (S.67).

It should be noted that as every disclaimer is bound to affect the rights of third parties, it is the duty of the Official Assignee to see that he exercises this power as far as possible with the least amount of interference with the right and liabilities of others. Persons who are injured by a disclaimer are deemed creditors and as such are entitled to prove to the amount of the injury as a debt under the insolvency.

Proof of Insolvency

On this question our Section 46 and Section 30 of the English Act of 1914 lays down that a creditor may prove *all debts and liabi-*

⁹ *Laxmiram Kevalram Bhatt v. Punamchand Pitamber*, 22 Bom. L.R. 1173

ilities, present or future certain or contingent, to which the debtor is subject to when he is adjudged an insolvent, or to which he may become subject to before discharge, by reason of any obligation incurred before the date of such adjudication. The only exceptions being—

(1) Demands in the nature of unliquidated damages arising otherwise than by reason of a contract, or breach of trust.

(2) Debts or liabilities contracted with a person who had notice of the presentation of insolvency petition by or against the debtor. This second clause does not occur in the corresponding section of the Provincial Act therefore such a debt or liability would be provable under the Provincial Act.

(3) Contingent debts and liabilities provable in insolvency.

(4) Debts which are not provable under the general policy of the law such as gambling debts, debts founded on illegal or immoral considerations, etc., must be estimated by the Official Assignee, as to their provable value and in case of debts the value of which is incapable of being fairly estimated in the opinion of the Official Assignee, he must issue a certificate to that effect and thereupon the debt or liability will be deemed to be a debt not provable in insolvency.

A creditor who fails to prove a debt or liability which is provable in insolvency cannot sue the insolvent after his discharge. Where a creditor had submitted his claim to the Official Assignee, but owing to an error in his office the final dividend was paid out without this creditor being paid, the Court held that as this was a payment in mistake of fact the Official Receiver was entitled to a refund of the proportion belonging to this creditor from other creditors.¹⁰

Unliquidated damages which cannot be proved in insolvency are those arising from tort, such as libel, trespass, or misrepresentation in the prospectus. Damages arising out of contract are provable in bankruptcy.¹¹

Proof by Different Types of Creditors

The general rule is that any person to whom a debt is due or who has a right to present a petition may prove in an insolvency. Where the payment of a debt is *guaranteed* and the principal debtor becomes insolvent, the creditor can prove for the full amount of the

¹⁰ *J Bala Devi v. The Official Assignee of Calcutta*, 54 Cal. 251.

¹¹ *Jack v. Kipling* (1882), 2 Q.B.D. 113

debt and then recover from the surety the amount of deficiency. The surety cannot also prove as there cannot be *double proof* of the same debt, but if the surety has paid the *whole* amount due to the creditor he, the surety, is entitled to prove and not the creditor. The liability in respect of the winding up of a joint-stock company can also be proved in the insolvency of the contributory. *An executor who is also a creditor of the deceased* has a right of retainer in *English law* by which he can retain the money due to him from the estate of the deceased insolvent of which he is the executor but in *Indian law* he has no such right, and therefore he can prove like any other creditor, in the insolvency of the deceased for the debt due to him.¹² *The holder of a bill of exchange* has a similar right to prove in the insolvency of each of the prior parties to the bill and receive a dividend from each estate upon the whole debt, provided he does not get a larger amount than the one which is covered by the bill.¹³ *The person who has endorsed a bill of exchange for the accommodation of another person* is in the position of a surety and can prove in the insolvency of the person accommodated by him.¹⁴ A creditor whose debt is secured may (1) realise his security and prove for the balance, (2) relinquish his security for the several benefit of the creditors and prove for the whole debt, (3) state in his proof the particulars of his security, and the value at which he assesses it and prove for the balance after deducting the assessed value.

REALIZATION OF THE DEBTOR'S PROPERTY

With regard to the realization of the debtor's property Section 68 states as follows:—

(1) Subject to the provisions of this Act, the Official Assignee shall with all convenient speed, realize the property of the insolvent and for that purpose may—

- (a) sell all or any part of the property of the insolvent;
- (b) give receipts for any money received by him;

and may, by leave of the Court, do all or any of the following things, namely—

- (c) carry on the business of the insolvent so far as may be necessary for the beneficial winding up of the same;

¹² Indian Succession Act, 1925, S 323

¹³ *Ex parte Rushforth* (1805) 10 Ves. 409, p. 416

¹⁴ *Haig v. Jackson* (1838), M. and W. 598

- (d) institute, defend or continue any suit or other legal proceedings relating to the property of the insolvent;
 - (e) employ a legal practitioner or other agent to take any proceedings or do any business which may be sanctioned by the court;
 - (f) accept as the consideration for the sale of any property of the insolvent a sum of money payable at a future time or fully paid shares, or debentures or debenture stock in any limited company subject to such stipulation as to security and otherwise as the court thinks fit;
 - (g) mortgage or pledge any part of the property of the insolvent for the purpose of raising money for the payment of his debts or for the purpose of carrying on the business;
 - (h) refer and dispute to arbitration, and compromise all debts, claims and liabilities, on such terms as may be agreed upon;
 - (i) divide in its existing form amongst its creditors according to its estimated value, any property which, from its peculiar nature or other special circumstances, cannot readily or advantageously be sold.
- (2) The official Assignee shall account to the court and pay over all monies and deal with all securities in such manner as is prescribed or as the Court directs.

THE OFFICIAL ASSIGNEE

We have noticed what part the Official Assignee plays in the realization of the debtor's property. The Official Assignee is an officer appointed in Bombay by the State Government of Bombay, in Madras by the Chief Justice of the High Court at Madras, and in West Bengal by the State Government of West Bengal after consultation with and with the concurrence of the Chief Justice of the High Court at Calcutta. He may be called upon to give such security and is subject to such rules as may be prescribed in (S. 77). He has a right to administer oath for the purpose of affidavits, verifying proofs, petitions or other proceedings under this Act and his duties shall have relation to the *conduct of the insolvent* as well as to the *administration of his estate*. In particular, it shall be the *duty of the Official Assignee*—

- (a) to investigate the conduct of the insolvent and to report to the court upon any application for discharge, stating whether there is reason to believe that the insolvent has committed any act which constitutes an offence under this Act or

under Sections 421 to 424 of the Indian Penal Code, in connection with his insolvency or which would justify the court in refusing, suspending or qualifying an order for his discharge;

(b) to take such other reports concerning the conduct of the insolvent as the court may direct or as may be prescribed; and

(c) to take such part and give such assistance in relation to the prosecution of any fraudulent insolvent as the court may direct or as may be prescribed.

He would have the right to sue and be sued by the name of "the Official Assignee of the property of an insolvent", inserting the name of the insolvent (Ss. 78, 79 & 83).

In Bombay and Madras by a local Amendment Act it is provided that the Official Assignee shall be a corporation sole by the name of the Official Assignee of Bombay and shall have a perpetual succession and an official seal and may sue and be sued in his corporate name and may do all acts necessary or expedient to be done in the execution of his office.

In the administration of the property, the Official Assignee should have regard to any resolution that may be passed at a meeting of the creditors, of course, subject to the provision of the law and the decision of the court. He may call meetings of creditors from time to time for the purpose of ascertaining their wishes, and it shall be his duty to summon meetings at such times as the creditors by resolution at any meeting, or the Court, may direct, or wherever he is requested to call the meetings of one-fourth in value of the creditors who have proved their claims (S.85).

Committee of Inspection

The Court may, if it thinks fit, *authorize the creditors who have proved their claims to appoint from among themselves a committee of inspection for the purpose of superintending the administration of the insolvent's property by the Official Assignee.* The committee's powers of control over the Official Assignee may also be prescribed by the Court (S.88). As regards Bombay, a committee shall consist of not more than five and not less than three. It shall meet at such time and place as may from time to time be appointed and failing such appointment at least once in a month. It may act by a majority of its members present at a meeting, but unless a majority of the committee is present, it shall not act. Where the committee has been appointed under Section 88 of this Act the Official Assignee shall, in the administration and distribution of the property of the insolvent have regard to any direction that may be given by the committee

but any direction given to the official assignee by resolution of the creditors at a meeting shall, in case of conflict, override any directions given by the committee. Again, where a committee of inspection is appointed, the official Assignee shall consult the committee before applying to the court for leave to do any of the acts under Section 68 for which the leave of the Court is required as per paragraph on duties and powers of the Official Assignee.¹⁵

Remuneration of the Official Assignee

The Official Assignee's remuneration would depend upon what is prescribed by the Rules.

Distribution of Property

The official assignee has to declare and distribute the dividends among creditors who have proved their debts *with all convenient speed*, and it is laid down that *the first dividend* (if any) shall be *declared and within one year after the adjudication* unless there is a good cause for postponing the declaration. The *subsequent dividends*, unless there is sufficient reason to the contrary, must be declared and be payable *at intervals of not more than six months*. The notice of the intention to declare a dividend would be published in the prescribed manner and must be sent to each creditor named in the insolvent's schedule. After declaring a dividend, every creditor should be sent the notice showing the amount of dividend and how it is to be paid (S 69). It may be noted that no such period or notice is mentioned in the Provincial Act.

In the *calculation and distribution of dividends*, the Official Assignee must retain in his hands sufficient assets to meet the following:—

- (a) debts provable in insolvency and appearing from the insolvent's statement or otherwise to be due to persons resident in places so distant that in the ordinary course of communication they have not had sufficient time to tender their proofs;
- (b) debts provable in insolvency the subject of claims not yet determined;
- (c) disputed proof of claims; and
- (d) the expenses necessary for the administration of the estate or otherwise (S.71).

If it happens that any creditor has not proved his debt before the declaration of the dividend, that creditor shall be entitled to be paid out of any money which happens to be in the hands of the Official Assignee before it is applied to the payment of any future dividend (S.72). *After all the assets have been realized*, or at least so much of them as can be realized without needlessly protracting the

¹⁵ Pres. T. Insol, Rules Bm. 184-186

proceedings in insolvency, *the Official Assignee shall, with the leave of the Court, declare a final dividend*. Before doing so, however, he must send notice to the persons who claim to be the creditors, but who have not proved their claims, inviting them to do so with a notice that if they do not prove the same within the time limited by the notice he would proceed to make the final dividend without regard to their claims. After this the property of the insolvent shall be divided among the creditors who have proved their debts, without regard to the claims of any other persons (S. 73). If, after the payment of all the claims in full with interest and expenses, there remains a balance, the insolvent shall be entitled to such a balance (S. 76).

Effect of Insolvency on Antecedent Transactions

With regard to transactions entered into by the insolvent prior to his insolvency, all *bona fide* transactions are generally speaking, protected, such as—

- (1) any payment by the insolvent to any of his creditors which does not fall under the heading of fraudulent preference;
- (2) any payment or delivery to the insolvent *bona fide*;
- (3) any transfer by the insolvent for valuable consideration; and
- (4) any contract or dealing by or with the insolvent for valuable consideration.

The only condition precedent to these is that such transactions ought to have taken place *before* the date of the *order of adjudication* and that the person with whom such transactions have taken place had *not, at the time, notice of the presentation of any insolvency petition* by or against the debtor (S. 57). Any transfer of property in consideration of marriage or in favour of a purchaser or incumbrancer in good faith would also be good. Other transactions, if made two years prior to the date of adjudication, would be protected (S. 55).

Execution Creditors

Where a creditor has obtained a decree of execution against the property of a debtor he is not entitled to retain this against the Official Assignee unless he has realized the assets in the course of execution by sale of otherwise before the date of the admission of the insolvency petition. Otherwise any creditor or anyone interested may give notice of adjudication to the Court which is executing the decree, and on receipt of such a notice, the Court must direct that the property may be delivered to the Official Assignee if it still be in the possession of the Court. Of course, *the cost of execution will be a*

first charge on the property so delivered and the Official Assignee will have to satisfy the charge. If, however, the property has been sold under execution, any person who buys the same in good faith would acquire a good title against the Official Assignee (Ss. 53 & 54).

Fraudulent Preference

Fraudulent preference in insolvency is defined by Section 56 as—

(1) Every transfer of property, every payment made, every obligation incurred, and every judicial proceeding taken or suffered by any person unable to pay his debts as they become due from his own money in favour of any creditor with a view of giving that creditor a preference over the other creditors, shall, if such person is adjudged insolvent on a petition presented within three months after the date thereof, be deemed fraudulent and void as against the Official Assignee.

(2) This Section shall not affect, the rights of any person making title in good faith and for valuable consideration through or under a creditor of the insolvent.

The essential conditions to a fraudulent preference, therefore, are—

(1) That the payment is made by a person who is unable to pay his debts as they become due;

(2) that it is made to a creditor or to some one on his behalf;

(3) that it is made without any pressure;

(4) that it is made with the main and dominant intention of preferring that creditor to other; and

(5) the debtor is adjudged insolvent on a petition presented within three months after the date of the transfer of payment.

Preferential Debts

In the distribution of the property of the insolvent the following debts shall be paid in priority to all other debts and shall rank equally between themselves and must be paid in full, unless the property of the insolvent is insufficient to meet them, in which case they shall abate in equal proportions between themselves—

(a) all debts due to the Government or to any local authority;

(b) all salary or wages of any clerk, servant or labourer in respect of services rendered to the insolvent during four months before the date of the presentation of the petition, not exceeding three hundred rupees for each such clerk, and one hundred rupees for each such servant or labourer; and

(c) rent due to a landlord from the insolvent; provided the amount payable under the clause shall not exceed one month's rent (S. 49).

Set-off

Where there have been mutual dealings between an insolvent and a creditor, an account is to be taken of what is due from one party to

the other in respect of such mutual dealings, and the sum due from one party must be set-off against any sum due from the other party and the balance of the account shall be claimed or paid on either side. The *person claiming the set-off* against an insolvent's property should *not have had notice of the presentation of the insolvency petition against the debtor at the time of giving credit*, otherwise he would not be entitled to claim such a set-off (S. 47).

Partnership Property

In the case of partners the partnership property is applicable in the first instance, in payment of the partnership debts and the separate property of each of the partners is applicable in the first instance for the payment of their separate debts. Any surplus of either of the properties shall be dealt with as part of the other property, *i.e.* surplus out of private property, after paying private debts, shall be dealt with as a part of the partnership property and *vice versa* [S. 49 (4)].

The Order of Discharge

The insolvent can at any date, after the order of adjudication and after his public examination, apply to the Court to fix a date for the hearing of the application for discharge. With regard to the *public examination* it need only be stated that at such an examination the insolvent is examined upon oath when he should be ready to answer all questions that may be put to him by the Court or by his creditors concerning his affairs and the cause of his failure. The Official Assignee shall also take part in this examination. All the parties may be represented by legal practitioners. After this public examination, the Court hears the application for discharge in open Court and considers the report, if any, that the Official Assignee may have made as to the insolvent's conduct and affairs. The report of the Official Assignee is *prima facie* and not conclusive evidence of the statement therein, and therefore the Court may look into the evidence on which the report is based. The Court may either—

- (a) grant or refuse an absolute order of discharge; or
- (b) suspend the operation of the order for a specified time; or
- (c) grant an order of discharge subject to any conditions with respect to any earnings or income which may afterwards become due to the insolvent, or with respect to his after-acquired property [S. 8].

The Court must refuse the discharge in all cases where the insolvent has committed any offence under the Insolvency Act or under

Sections 421 to 424 of the Indian Penal Code. Where the insolvent's assets are not of a value equal to four annas in the rupee on the amount of his unsecured liabilities, the Court may either refuse the discharge, or suspend it for a specified time or until a dividend of not less than four annas in the rupee has been paid, unless the court is satisfied that the fact that the assets are not of such value has arisen from circumstances for which the insolvent cannot justly be held responsible. *The Court may, under the same circumstances, discharge the insolvent on his consenting to a decree being passed against him in favour of the official assignee for any balance, or part thereof, provable under the insolvency which is not satisfied at the date of his discharge to be paid by him out of his future earnings or after-acquired property.* The same rule would apply where the insolvent has omitted to keep proper books of account, or has continued to trade after knowing himself to be insolvent, or has contracted any debt provable in insolvency without having at the time any reasonable or probable ground of expectation that he would be able to pay it, or where the insolvency has been brought about by *rash and hazardous speculation* or by *unjustifiable extravagance* or by *gambling* or by *culpable neglect* of his business affairs, or where the insolvent has put his creditors to unnecessary expense by a *frivolous or vexatious defence to any suit* properly brought against him, or incurred unjustifiable expense within three months preceding the time of presentation of the petition by bringing a *frivolous or vexatious suit* or within three months previous to the date of petition, when unable to pay debts, has given an *undue preference* to any of his creditors. The same result would follow if the insolvent has *concealed or removed his books or his property*, or has been guilty of *fraudulent breach of trust* [S. 39].

As has already been mentioned, certain debts are not wiped off by an order of discharge. Except for this, an order of discharge will release the insolvent from all debts provable in insolvency. Such an order will also be *conclusive evidence* of the insolvency and of the validity of the insolvency proceedings. However, an order of discharge would not release a person who at the date of the presentation of the petition was a partner or co-trustee with the insolvent or was jointly bound or had made any joint contract with him. It will also not release any person who was surety or in the nature of a surety for the insolvent [S. 45].

Small Insolvency

Under the Presidency-towns Insolvency Act, when the estate of the insolvent debtor is not likely to exceed in value *Rs 3,000 or such*

lesser amount as may be prescribed, the Court may order that the estate be administered in a summary manner as a small insolvency. In such a case there is no public examination of the insolvent, unless and the creditors or the Official Assignee require it. As far as possible practicable, the estate must be distributed in one dividend [S. 106].

PROVINCIAL INSOLVENCY ACT, 1920

This Act extends to India as administered by Courts having jurisdiction outside the Presidency-towns whereas, as we have seen earlier in the Chapter, the Presidency-towns Insolvency Act applies to the Presidency-towns. The Courts outside the Presidency-towns which administer *jurisdiction* under this Act are the District Courts, unless the State Government by notification in the Official Gazette invests any Court subordinate to a District Court with jurisdiction in any classes of cases, and any Court so invested shall within the local limits of its jurisdiction have concurrent jurisdiction with the District Court under this Act.

Court Decide Questions

The Court having jurisdiction shall have full power to decide all questions whether of title or priority, or of any nature whatsoever, and whether involving matters of law or of fact, which may arise in any case of insolvency coming within the cognisance of the Court, or which may be considered expedient or necessary to decide for the purpose of doing complete justice or making a complete distribution of property in any such case. Such decision shall be binding and final [S. 4]. This section, virtually speaking, corresponds to Section 7 of the Presidency-towns Insolvency Act of 1909. It has been decided that a Court can, under that Act inquire into a waqf executed by an insolvent.¹⁶ The Court can here inquire into a disputed title and order delivery of the property to the purchaser from the official receiver. The proceedings are to be with the same procedure and powers as the Court has and which the Court exercising jurisdiction in this matter can exercise within its original civil jurisdiction.

Acts of Insolvency

The acts of insolvency under this Act (S. 6) are the same as in Section 9 of the Presidency-towns Insolvency Act.

¹⁶ *Abdul Hasan Khan v. B Rajbir Prasad* (1930) I. L. R. 6 Luck 614

Insolvency Notice

In Bombay the same provisions regarding insolvency notice apply as in the Presidency-towns Insolvency Act which has already been mentioned.

Adjudication and petition

Where a debtor commits one of the acts of insolvency dealt with above a petition may be presented for his adjudication in insolvency, either by his creditor or by the debtor himself. In fact, *where a debtor himself petitions, the presentation of such a petition by him is an act of insolvency by itself independent of any other act deemed to be an act of insolvency.* The petition must be presented to a Court which has *jurisdiction* in any local area in which the debtor ordinarily resides or carries on business, or personally works for gain, or if he has been arrested or imprisoned, where he is in custody (S. 11). Notice that unlike in the corresponding Section (11) of the Presidency Towns Insolvency Act no particular period of residence etc. is here prescribed. The Provincial Act also contains a proviso to Section 11 under which no objection as to the place of presentment can be taken in the exercise of appellate or revisional jurisdiction unless it was taken in the Court by which the petition was heard at the earliest possible opportunity, and unless there has been a consequent failure of justice.

Creditor's Qualification

A creditor is not entitled to present an insolvency petition, unless—

- (1) *the debt owing to the creditor or jointly to creditors, where two or more creditors join in the petition,*
- (2) *comes to the aggregate amount of not less than Rs 500,*
- (3) *the debt is a liquidated sum either payable immediately or at some future time, and*
- (4) *the act of insolvency has committed within three months before the presentation of the petition (S. 9).*

There is, of course, no objection to present a petition on the same day as on that on which the act of insolvency was committed. *If the petitioning creditor is a secured creditor, he must give an estimate of the value of the security and will be admitted as a creditor to the extent of the balance of the debt due to him after the deduction of the value as estimated, unless the petitioning secured creditor is prepared to relinquish his security for the benefit of the creditors.*

Debtor's Qualification

If, however, the *petition is presented by the debtor* he shall not be entitled to do so unless—

- (1) he is unable to pay his debts,
- (2) the debts amount to Rs 500, or
- (3) he is under arrest or imprisonment in execution of the decree of any Court for the money; or

(4) an order of attachment in execution of such a decree has been made, and is subsisting, against his property (S. 10). It may, however, be added that joint stock companies or corporation which were formed under any enactment for the time being in force, cannot be petitioned in an insolvency Court. Once a petition is presented it cannot be withdrawn without the leave of the Court (S.14). However, if two or more insolvency petitions are presented against the same debtor or where separate petitions are presented against joint debtors, the Court may consolidate the proceedings or any of them, as the Court thinks fit (S.15). Should the debtor against whom the petition has been presented die, the Court may continue the proceedings so far as may be necessary for the realization and distribution of the property of the debtor (S.17). Here it makes no difference whether the petition is presented by a creditor or the debtor himself.¹⁷ The heirs of the deceased insolvent, however, will have to be brought on the record for further proceedings after his death.

Interim Receiver

The Court may appoint an interim receiver and while admitting the insolvency petition it may, where the petition is by a creditor, and shall, if it is by the debtor appoint, an interim receiver of the property of the debtor, who may be directed to take immediate possession of the property. The receiver has the usual powers of a receiver under the Civil Procedure Code (S 20).

Interim Proceedings Against the Debtor

At the time of making the order admitting the petition or at any subsequent date prior to adjudication, the Court may either *of its own motion or on the application of any creditor*—

- (1) order the debtor to give reasonable security for his appearance until final orders are made upon the petition, and in case of default of giving such security he shall be detained in the civil prison;

¹⁷ *Ramathai Anni v. Konnlappa Mudaliar* (1928), I.L.R. 51 Mad. 495

(2) order the attachment by actual seizure of the whole or any part of the property in the possession of or under the control of the debtor, other than such particulars (not being his books of account) as are exempted by the Civil Procedure Code, or by any other enactment for the time being in force from liability to attachment and sale in execution of a decree;

(3) order a warrant to issue with or without bail for arrest of the debtor, ordering either that he should be detained in a civil prison or be released on such terms as to security as may be reasonable and necessary.

The order under Clauses 2 and 3 shall not be made unless the Court is satisfied that the debtor, with intent to defeat or delay his creditors or to avoid any process of the Court, has absconded or has departed from the local limits of the jurisdiction of the Court, or is about to do so; or where the debtor has failed to disclose or has concealed, destroyed, transferred or removed from such local limits, or is about to do so, any documents likely to be of use to his creditors in the course of the hearing, or any part of his property (S.21). There is no provision in the Presidency-towns Insolvency Act equivalent to the provisions under Sections 21 to 33 of this Act, for the simple reason that in the *Presidency-towns Insolvency Act* there is no intermediate stage between the presentation of the petition and the actual adjudication of the debtor, as there is in other courts of India.

The debtor, of course, during the interim proceedings, must produce all books of accounts and give such inventories of his property and lists of his creditors and debtors and of the debts due to and from them as may be required. He must also submit himself to such examination in respect of his property or his creditors and attend on due dates and times appointed by the Court before the Court or Receiver, execute instruments and generally do all such acts in relation to his property as he may be required to do by the Court or the Receiver (S.22).

Hearing of the Petition

On the date appointed by the Court for the hearing of the petition and on subsequent days during which the hearing progresses, the first duty of the Court will be to be satisfied that the creditor or the debtor, as the case may be, is entitled to present the petition. Where the petition is presented by a creditor and the debtor is not present, the Court has to be satisfied that notice of the order admitting the petition has been served on the debtor. Last but not the

least, it must be established that the debtor has committed an act of insolvency as alleged against him. If the debtor is present, the Court shall examine him as to his conduct, dealings and property in the presence of such creditors as appear at the hearing, and the creditors shall have the right to put such questions to the debtor on the petition as are relevant [S.24]. If the Court is not satisfied at the hearing of the petition with the proof of any of these, it shall dismiss the petition [S.25]. Not only this, but in case of the creditor's petition the Court may even award compensation to the debtor not exceeding Rs 1,000 if it is satisfied that the petition was frivolous or vexatious [S 26].

Order of Adjudication

If at the hearing the Court is satisfied as to the proofs produced, an order of adjudication shall be made in which the Court must specify the period during which the debtor must apply for his discharge. This period may be extended at the discretion of the Court. The effect of the adjudication order is that the whole of the property of the debtor vests in the Court or the official receiver and becomes divisible among creditors. The result is that *all properties belonging to the insolvent debtor, or under his order or disposition in his trade or business, fall under the power of the Court or Receiver*. Not only this but all other property which devolves on the insolvent debtor or is acquired by him after the adjudication order and before the discharge also forthwith vests with the Court or Receiver.

Notice of the order of adjudication must be published in the local Official Gazette and in such other manner as may be presented.

Doctrine of Relation Back

The doctrine of relation back has been fully dealt with in connection with the Presidency-towns Insolvency Act and should be carefully studied. This doctrine in the Provincial Insolvency Act occurs under section 28 (7), which lays down that an order of adjudication relates to and takes effect from the date of the presentation of the petition on which it is made.

Proof by Creditors

After the adjudication order all persons who claim to be creditors of the insolvent must tender proof of their respective debts as to the amount and particulars thereof and the Court, by order, determines the persons who have proved themselves to be creditors of the insol-

vent stating the amount for which they have so proved. *Thus a schedule of creditors and their claims* is to be prepared. Any debt, the value of which is incapable of being proved and ascertained in the opinion of the Court, should not be included in the schedule. This schedule must be posted in the Court house [S. 33].

Annulment by the Court

Where the Court thinks that the debtor ought not to have been adjudged an insolvent or that the insolvency debts have been paid up in full, the Court, on application by the debtor, or any other person interested, will annul the adjudication [S. 35].

Composition and Schemes of Arrangement

After the making of the order of adjudication, it is quite open for a debtor to submit a proposal for a composition in satisfaction of his debts, or a proposal for a scheme or arrangement of his affairs, whereupon the Court fixes a date for the consideration of the composition, issuing notices to all creditors. If at the creditor's meeting when the scheme of composition or of arrangement is placed before them, a majority in number and three-fourths in value of all the creditors whose debts are proved and who are present in person or by pleader resolve to accept the proposal, it shall be deemed to be duly accepted by the creditors. The Court thereupon has the option either to approve or refuse the proposal as it thinks fit. The Court may, if it is of the opinion, after hearing the report of the receiver, where a receiver is appointed, and after considering any objections which may be made by or on behalf of any creditor, that the terms of the proposal are not reasonable or are not calculated to benefit the general body of creditors, refuse to approve the proposal. In any other case the Court may either approve or disapprove [S. 38].

Debts not wiped off by Discharge or Composition

The debts which are not wiped off by discharge or composition are the same as in the case of the Presidency-town Insolvency Act under Section 45 of that Act, from which the Provincial Insolvency Act, Section 44 has been adopted. These debts have already been given in detail in this Chapter.

Order of Discharge

An insolvent may apply for his discharge at any time after his adjudication and the *Court fixes a day* giving notice in such a manner as may be prescribed for the hearing of the application of discharge.

The Court after the hearing may pass any of the following three orders:—

- (1) grant or refuse an absolute order of discharge; or
- (2) suspend the operation of the order for a specified time; or
- (3) grant an order of discharge subject to any conditions with respect to any earnings or income which may afterwards become due to the insolvent, or with respect to his after-acquired property [S. 41 (2)].

Where there is reason to refuse the discharge the Court may do so even though there is no opposition to it. If, however, the Court imposes conditions to the discharge, it has been laid down that the conditions should not be so imposed as to make them tantamount to an absolute refusal of discharge.¹⁸ *The Court must refuse an absolute order of discharge if it is proved that—*

(1) the insolvent's assets are not of a value equal to eight annas in the rupee on the amount of his unsecured liabilities, unless it is shown by the insolvent that this position has risen from circumstances for which he cannot justly be held responsible;

(2) the insolvent has omitted to keep books of account as are usual and proper in the business carried on by him with a view to sufficiently disclose his business transactions and financial position within the three years immediately preceding his insolvency.

(3) that the insolvent has continued to trade after knowing himself to be insolvent;

(4) the insolvent has contracted any debt provable under this Act without having at the time of doing so any reasonable or probable ground or expectation that he would be able to pay it;

(5) he has failed to account satisfactorily for any loss of assets or for any deficiency of assets to meet his liabilities;

(6) the insolvent has brought on, or contributed to his insolvency by rash speculation, or unjustifiable extravagance in living, or gambling, or culpable negligence of his business affairs;

(7) the insolvent has within three months preceding the date of the presentation of the petition given an undue preference to any of his creditors;

(8) the insolvency on any previous occasion has been adjudged an insolvent or made a composition or arrangement with his creditors;

¹⁸ *Re James, Ex parte James* (1890), 25 Q.B.D. 285

(9) he has concealed or removed his property or any part thereof or has been guilty of any other fraud or fraudulent breach of trust [S. 42].

Set-off

This point has been dealt with in connection with the Presidency-towns Insolvency Act, which should be referred to as the law is the same on this point.

Fraudulent Preference

In connection with preferential *transfers and payments*, i.e. where the insolvent pays after committing an act of insolvency any creditor in full in priority to other creditors, the *essential conditions to be proved in a Court of law*, are—

- (1) that the payment is made by a person who is an insolvent;
- (2) that it is made to a creditor or to some one on his behalf;
- (3) that it is made without any pressure;
- (4) that it is made with the main and dominant intention of preferring the creditor to others; and
- (5) that the debtor has been adjudged insolvent on a petition presented within 3 months after the date of the transfer or payment [S. 54].

Official Receiver

The State Government may appoint such persons as it thinks fit as “Official Receiver” for any local limits and in that case the Court under whose jurisdiction he so acts may appoint him as receiver for the purpose of every order appointing a receiver or an interim receiver. The Official shall receive such remuneration as the State Government may fix. Where no receiver is appointed the Court shall have all the rights of and may exercise all the powers conferred on a receiver under this Act [Ss. 57 & 58].

Powers and Duties of the Official Receiver

The powers and duties of a receiver so appointed are that—

- (1) he can sell all or any part of the property of the insolvent;
- (2) give receipts for any money received by him; and with the consent of the Court may—
 - (a) carry on the business of the insolvent so far as may be necessary for the beneficial winding up of the same;
 - (b) institute, defend or continue any suit or other legal proceedings relating to the property of the insolvent and for

that purpose employ a pleader or other agent to take any proceedings or do any business which may be sanctioned by the Court;

(c) accept as the consideration for the sale of any property of the insolvent a sum of money payable at a future time subject to such stipulation as to security as the Court may think fit;

(d) mortgage or pledge any part of the property of the insolvent for the purpose of raising money for the payment of his debts;

(e) refer any dispute to arbitration, and compromise all debts, claims and liabilities; on such terms as may be agreed upon;

(f) divide in its existing for among the creditors, according to its estimated value, any property which, from its peculiar nature or other special circumstances, cannot readily or advantageously be sold (S. 59).

Priority of Debts

In the payment of debts while distributing the debtor's property, *after all secured creditors have been paid out of their securities, the following have priority, viz—*

(1) all debts due to the Government or to any local authority and

(2) all salary or wages, not exceeding Rs 20 in all, of any clerk, servant or labourer in respect of services rendered to the insolvent during four months before the date of the presentation of the petition.

These debts rank in priority between themselves, unless the property of the insolvent is insufficient to meet them in which case they must be paid in equal proportions between themselves. In case of partners, the partnership property is applicable in the first instance to the payment of the partnership debts. Where there is a surplus of separate property of the partners, it is to be dealt with as part of the partnership property; and where there is a surplus of the partnership property, it must be dealt with as part of the respective separate property in proportion to the rights and interests of each partner in the partnership property. If all the debts are paid off and a surplus remains, it must be applied in payment of interest from the date on which the debtor is adjudged an insolvent at the rate of 6 per cent per annum on all debts entered in the schedule. If after payment of all debts there is a surplus, the surplus, of course, belongs to the insolvent [S. 61].

Small Insolvency

Under the Provincial Insolvency Act, the Court can order that the property of the debtor be administered as a small insolvency, in a summary manner, if the property of the insolvent *is not likely to exceed in value to Rs 500*. The estate is administered, and dividend is paid as a single dividend. Unless the Court otherwise orders, the small insolvency is not to be gazetted. The debtor must apply for his discharge within six months from the date of adjudication. [S.74].

SUMMARY

Law of Insolvency

(1) The Presidency Towns Insolvency Act, 1909 which applies to the Presidency towns of Bombay, Calcutta and Madras, and

(2) the Provincial Insolvency Act, 1920, which applies to the rest of India.

Main Objects of Insolvency Law

(1) To protect the debtor against harassment by his creditors and

(2) to secure an equitable and speedy distribution of the debtor's property among his creditors.

Who can be made Insolvent

Anyone of sound mind and full age if (1) he is a debtor and (2) he has committed an act of insolvency.

Commencement of Insolvency

Under the Presidency Towns Insolvency Act and the English Bankruptcy Act—date of the first available act of insolvency.

Under the Provincial Insolvency Act—on presentation of the petition.

Creditor's Petition

(1) Aggregate debts amount to Rs 500.

(2) Liquidated sum.

(3) Act of insolvency by debtor.

(4) Act of insolvency committed within 3 months before petition.

Debtor's Petition

(1) Debt amounts to Rs 500.

(2) Debtor is under arrest or imprisoned in execution of a money decree.

(3) An order of attachment is subsisting against his property in execution of such a decree.

Procedure on Admission of Petition

Presidency Act: If Court is satisfied with the proofs of creditors it will pass an order of adjudication. The court may appoint an Interim Receiver if necessary.

Provincial Act: In case of creditor's petition, Court may, and if debtor's petition Court must, appoint an Interim Receiver, pass interim order, hear petition and pass order of adjudication.

Acts of Insolvency

(a) If, in India or elsewhere, he makes a transfer of all or substantially all his property to a third person for the benefit of his creditors generally;

(b) if, in India or elsewhere, he makes a transfer of his property or of any part thereof with intent to defeat or delay his creditors;

(c) if, in India or elsewhere, he makes a transfer of his property or of any part thereof, which would, under this or any other enactment for the time being in force, be void as a fraudulent preference if he were adjudged an insolvent;

(d) if, with intent to defeat or delay his creditors,

[i] he departs or remains out of India,

[ii] he departs from his dwelling-house or usual place of business or otherwise absents himself,

[iii] he secludes himself so as to deprive his creditors of the means of communicating with him;

(e) if any of his property has been sold or attached for a period of not less than 21 days in execution of the decree of any Court for the payment of money;

(f) if he petitions to be adjudged an insolvent;

(g) if he gives notice to any of his creditors that he has suspended, or that he is about to suspend payment of his debts;

(h) if he is imprisoned in execution of the decree of any Court for the payment of money;

(i) if, after a creditor has served an insolvency notice on him under this Act in respect of a decree or an order for the payment of any amount due to such creditor, the execution of which is not stayed, he does not, within the period specified in the notice which shall not be less than one month, either comply with the requirements of the notice or satisfy court that he has a counter claim or set-off which equals or exceeds the decretal amount or the amount

ordered to be paid by him and which he could not lawfully set up in the suit or proceeding in which the decree or order was made against him.

Effect of Order of Adjudication

(1) The whole of the insolvent's property rests in the Official Assignee (under the Presidency Towns Insolvency Act) or in the Court or Receiver for being divided among the creditors.

(2) The debtor can no longer deal with the property.

(3) The debtor is disqualified from holding certain offices.

(4) The debtor is released from his liabilities pending insolvency proceedings.

(5) Suits and other court proceedings are stayed.

(6) The order relates back to the commencement of the insolvency.

Protected Transactions

(1) Any payment by an insolvent to any of his creditors.

(2) any payment or delivery of property to the insolvent;

(3) any transfer by the insolvent for valuable consideration or

(4) any contract or dealing by or with the insolvent for valuable consideration.

Doctrine of Relation Back

On passing of the order of adjudication the insolvency relates back to the date of the commencement of the insolvency which is

Under the Presidency Towns Insolvency Act—the date of the first act of insolvency.

Under the Provincial Insolvency Act—the date of the presentation of the petition.

Protection Order

A Protection Order is an order of the Court by which the insolvent is protected from being arrested or detained in prison for any debt to which the order applies.

Composition or Schemes of Arrangement

Only after the adjudication order the insolvent may propose a scheme of composition or arrangement through the Official Assignee to a meeting of creditors. On approval of the scheme the Court will annul the adjudication and the property of the debtor will revert in him.

Debts Not Wiped Out by Composition or Discharge

(a) Any debt due to the Government;

(b) any debt or liability incurred by means of any fraud or fraudulent breach of trust to which the debtor was a party;

(c) any debt or liability in respect of which the debtor has obtained forbearance by any fraud to which he was a party; or

(d) any liability under an order for maintenance made under Section 488 of the Code of Criminal Procedure, 1898.

Debtor's "Property"

Includes—any property over which or over the profits of which any person has a disposing power which he may exercise for his own benefit.

Does not include—(i) property held by the insolvent in trust for any other person; (ii) the tools, if any, of his trade, and the necessary wearing apparel, bedding, cooking vessels and furniture for himself, his wife and children, to a value, inclusive of tools and apparel and other necessities as aforesaid not exceeding Rs 300 on the whole. (iii) Property in a foreign country.

Doctrine of Reputed Ownership

Applies only to traders.

Aims at protection of general creditors of a trader against false credit given on goods in the debtor's possession which ostensibly appear to belong to the debtor.

Thus not only goods actually belonging to a debtor but also, if he is a trader, those under his "order or disposition" vest in the Official Assignee or Receiver provided the following conditions are fulfilled:—

(1) the property must be goods;

(2) the goods must be in the possession, order or disposition of the insolvent, in his trade or business at the commencement of the insolvency and under such circumstances that he is the reputed owner; and

(3) the true owner should have consented to such possession of the goods by the insolvent in his trade or business and under such circumstances that he is the apparent reputed owner thereof.

After acquired Property

Vests in the Official Assignee or Receiver only if they intervene on behalf of the insolvent's estate.

Debtor's Property in Foreign State

Does not vest in the Official Assignee or Receiver.

Onerous Property

Within 12 months after the order of adjudication the Official Assignee or Receiver has the option to disclaim in writing any property which is unsaleable or not readily saleable.

Debts Provable in Insolvency

(1) All debts and liabilities, present or future, certain or contingent, to which the debtor is subject at the time of the adjudication order.

(2) All debts and liabilities to which he may become subject after his adjudication but before his discharge by reason of any obligation which he may have incurred before such adjudication.

Debts Not Provable In Insolvency

(1) Demands in the nature of unliquidated damages arising otherwise than by reason of a contract, or breach of trust.

(2) Debts or liabilities contracted with a person who had notice of the presentation of insolvency petition by or against the debtor. This second clause does not occur in the corresponding section of the Provincial Act therefore such a debt or liability would be provable under the Provincial Act.

(3) Contingent debts and liabilities provable in insolvency.

(4) Debts which are not provable under the general policy of the law such as gambling debts, debts founded on illegal or immoral considerations, etc., must be estimated by the Official Assignee, as to their provable value and in case of debts the value of which is incapable of being fairly estimated in the opinion of the Official Assignee, he must issue a certificate to that effect and thereupon the debt or liability will be deemed to be a debt not provable insolvency.

Effect of Insolvency on Antecedent Transactions

All bona fide transactions entered into by the insolvent before the order of adjudication are protected provided the person with whom such transactions took place did not have at the time notice of the presentation of any insolvency petition by or against the debtor.

Protected Transactions

(1) Any payment by the insolvent to any of his creditors which does not fall under the heading of fraudulent preference;

(2) any payment or delivery to the insolvent bona fide;

(3) any transfer by the insolvent for valuable consideration; and

(4) any contract or dealing by or with the insolvent for valuable consideration.

Fraudulent Preference

A transfer by the insolvent is void as a fraudulent preference if—

- (1) the payment is made by a person who is unable to pay his debts as they become due;
- (2) it is made to a creditor or to some one on his behalf;
- (3) it is made without any pressure;
- (4) it is made with the main and dominant intention of preferring that creditor to others; and
- (5) the debtor is adjudged insolvent on a petition presented within three months after the date of the transfer or payment.

Order of Payment of Debts**(1) Preferential debts**

- (a) all debts due to the Government or to any local authority;
- (b) all salary or wages of any clerk, servant or labourer in respect of services rendered to the insolvent during four months before the date of the presentation of the petition, not exceeding three hundred rupees for each such clerk, and one hundred rupees for each such servant or labourer; and
- (c) rent due to a landlord from the insolvent: provided the amount payable under the clause shall not exceed one month's rent (S. 49).

(2) Other debts to be paid rateably after payment of preferential debts.

(3) In the case of a Partnership

- (a) Partnership property first in payment of partnership debts and surplus in payment of private debts of partners.
- (b) Separate property of each partner first in payment of his private debts and surplus in payment of partnership debts.

Order of Discharge

the Court may

- (1) grant an absolute order of discharge, or
- (2) refuse an absolute order of discharge, or
- (3) suspend the operation of the order for a specified time, or
- (4) grant a conditional order of discharge.

Small Insolvencies

In the following cases the Court may order the estate to be administered in a summary manner as a small insolvency and as far as possible the estate must be distributed in one dividend.

under the Presidency Act—if the value of the estate is not likely to exceed Rs 3,000

under the Provincial Act—if the value of the estate is not likely to exceed Rs 500.

TYPICAL QUESTIONS

1. A brother and a sister carry on business in partnership in the brother's name. The sister is a dormant partner and the business is carried on by the brother ostensibly as his own. The brother absconds and is adjudged insolvent. The Official Assignee wishes to take possession of the sister's share in the partnership stock on the ground that the insolvent brother was the reputed owner of the stock. Is he entitled to do so? Give reasons.
2. 'The effect of the doctrine of reputed ownership is to transfer to the Official Assignee property which does not belong to the insolvent.' Discuss the statement, explaining the range and scope of the doctrine.
3. What is meant by an Order of Adjudication? What is its effect? When may it be annulled and with what result?
4. Can (a) an infant, (b) a married woman, (c) a resident alien, (d) a lunatic, be adjudicated an insolvent?
5. (a) What are acts of insolvency?
(b) How can an Order of Adjudication be obtained by a debtor or by a creditor?
(c) What is an Interim Protection Order and how can it be obtained?
6. State the conditions on which an insolvency petition may be presented by a (1) creditor, (2) debtor.
7. What is a "Protection Order" and in what cases is it granted to an insolvent?
8. Explain—
(a) Reputed ownership, (b) Fraudulent preference, (c) Disclaimer of Leasehold. Give instances.
9. In what circumstances are goods said to be in the "reputed ownership" of an insolvent? If your firm, being compelled in the course of business to deposit goods with A in circumstances which might lead to "reputed ownership", asked you how such a contingency could be guarded against, what steps would you advise?
10. Under a scheme of arrangement entered into by a debtor with his creditors the debts are payable by instalments. The Court duly approves of the scheme. Default is then made by the debtor in payment of an instalment. Is the creditor entitled—

- (a) to sue for his debt as due originally,
 - (b) to sue for the instalment due.
 - (c) to take any other course and if so what proceedings for the recovery his debt?
11. (a) An insolvent debtor assigned his business and property to a private limited company, of which he became managing director. What steps could the creditors take?
- (b) Subsequently the company, finding itself in difficulties, went into liquidation and the liquidator sold the assets to a bona fide purchaser. Have the creditors any remedy?
12. When can an insolvent apply for his discharge, and what must the Court consider on the hearing of the application? State briefly what is the effect of an order of discharge.
13. What are powers of the Official Assignee as to realisation of an insolvent's property?
14. What are the rights of an Official Assignee as to —
- (a) property acquired, (b) salary earned by the insolvent after the Adjudication Order?
15. What are the acts of insolvency under the Presidency Towns Insolvency Act?
16. Explain any two of the following:—
- (a) Insolvent's schedule.
 - (b) Priority debts.
 - (c) Effects of order of annulment.

ARBITRATION

THE PRESENT Arbitration Act X of 1940 is a comprehensive Act specially passed in order to repeal the old Indian Arbitration Act IX of 1899 and the provisions of the Code of Civil Procedure and in its place to provide a complete legislation on the subject.

What is Arbitration

Arbitration is the name given to a method of settling disputes without litigation. According to Halsbury: "It is an agreement made by two or more parties between whom some difference has arisen or may thereafter arise whereby they appoint another person to adjudicate upon such dispute agree to be bound by his decision. The characteristic of arbitration is that it is a private tribunal chosen by the parties".

Arbitration Agreement

An Arbitration Agreement is defined by the Act 1940 as a written agreement to submit present or future differences to arbitration, whether an arbitrator is named therein or not [S. 2 (a)]. In the old Act this was called a "Submission". It will thus be seen that there cannot be an arbitration without.

- (1) a written agreement,
- (2) a present or future dispute, and
- (3) the dispute must be covered by the arbitration agreement.

Although the agreement must be in writing a formal document signed by the parties is not necessary.¹

Kinds of Arbitration

Arbitration may be—

- (1) without the Court's intervention,
- (2) through the Court, where no suit is pending, and
- (3) in suits.

(1) ARBITRATION WITHOUT INTERVENTION OF THE COURT

There must be no litigation pending at the time of the making of the award. The parties are, however, competent to make a valid reference of disputes in a pending suit, if they agree to arbitration without the supervision of a Court and to withdraw the suit, though a reference is made before such withdrawal of the suit.²

Who may refer to Arbitration?

Generally speaking, any person who can enter into a contract can submit to arbitration as long as he is *interested in the subject-matter*.

An *agent* duly authorised may enter into a submission agreement and bind his principal.

Partners usually provide in the partnership deed that any dispute arising between them with reference to partnership matters, would be decided by arbitration. Section 19 clause 2 (a) of the Indian Partnership Act of 1932 provides that in the absence of any usage or custom of trade to the contrary, the implied authority of a partner does not empower him to submit a dispute relating to the business of the firm to arbitration.

Insolvents cannot submit disputes, in respect to which they are parties, to arbitration so as to bind their estates. If they do so, it will have the effect of binding themselves personally and not their estates or the Official Assignee.

Minors cannot submit to arbitration so as to be bound by the award. The guardian of a *lunatic* may consent on behalf of a lunatic to a submission to arbitration.

¹ *Union of India v. A. L. Rallia*, A.I.R. 1963 Supreme Court 1685

² A I.R. 1961 Cal. 46

A Solicitor has no implied authority to bind his client by a reference to arbitration.

A Counsel has implied authority to refer to arbitration, an action in which he is briefed, if it is in the interest of the client. Such an implied authority does not extend to matters outside the suit, or where he is specifically instructed not to make reference to arbitration. A counsel can refer the suit to arbitration only in Court.

A company may, by written agreement, refer to arbitration in accordance with the Indian Arbitration Act, 1940, an existing or future difference between itself and any other company or person and for that purpose may delegate to the arbitrator the power to settle any terms or to determine any matter capable of being lawfully settled or determined by the company itself, or by its directors, managing director, managing agent, secretaries and treasurers or manager. The provisions of the Indian Arbitration Act, 1940, apply to the arbitration proceedings.³

What matters may be Referred

Generally speaking all matters, which can be made the subject of a contract, may be referred to arbitration. Thus, purely criminal matters cannot be submitted to arbitration; but any civil difference or civil right, for which a criminal prosecution is also instituted, may be referred to arbitration so far as the civil side of the question is concerned. A divorce suit cannot be submitted to arbitration, as in such cases the jurisdiction of the matrimonial court is exclusive. Similarly no insolvency matters can be decided by arbitration. Formerly it was held that the construction of a will can be referred to arbitration but later decisions hold that it cannot be so referred.⁴

Provisions Implied in an Arbitration Agreement

Section 3 provides that in an arbitration agreement, unless a different intention is expressed therein, shall be deemed to include the following provisions which have been set out in the First Schedule of the Act of 1940, as far as they may be applicable.

(1) Unless otherwise expressly provided, the reference shall be to a sole arbitrator.

(2) If the reference is to an even number of arbitrators the arbitrators shall appoint an umpire not later than one month from the latest date of their respective appointments.

(3) The arbitrators shall make their award within four months after entering on the reference or after having been called upon to act by notice in writing from

³ S. 389, Companies Act, 1956

⁴ Re. Wynn's Estate (1952) I.A.E.R. 341

any party to the arbitration agreement or within such extended time as the Court may allow.

(4) If the arbitrators have allowed their time to expire without making an award or have delivered to any party to the arbitration agreement or to the umpire a notice in writing stating that they cannot agree, the umpire shall forthwith enter on the reference in lieu of the arbitrators.

(5) The umpire shall make his award within two months of entering on the reference or within such extended time as the Court may allow.

(6) The parties to the reference and all persons claiming under them shall subject to the provisions of any law for the time being in force submit to be examined by the arbitrators or umpire on oath or affirmation in relation to the matter in difference and shall, subject as aforesaid, produce before the arbitrators or umpire all books, deeds, papers, accounts, writings and documents within their possession or power respectively, which may be required or called for, and do all other things which during the proceedings on the reference, the arbitrators or umpire may require.

(7) The award shall be final and binding on the parties and persons claiming under them respectively.

(8) The costs of the reference and award shall be in the discretion of the arbitrators or umpire who may direct to, and by whom, and may tax or settle the amount of costs to be so paid or any part thereof and may award costs to be paid as between legal practitioner and client.

The Arbitrator

The arbitrator is a person selected by the consent of the parties to an arbitration for the purpose of settling differences submitted to him. No particular qualification is required to be an arbitrator. Any person who is not subject to any legal incapacity can be appointed an arbitrator. The arbitrator, however, must not be interested in the subject-matter of the dispute or in any of the parties to the dispute. Thus, a party to a dispute cannot appoint one of his employees or relatives as an arbitrator. Similarly, a person who is heavily indebted to a party to the dispute cannot be appointed an arbitrator. The principle underlying this rule is that such an arbitrator cannot be expected to act fairly.

There are two types of interest which require to be considered as a disqualification for an arbitrator—

- (1) That which exists at the date of the arbitration agreement or at the date of the appointment as arbitrator, and
- (2) that which arises subsequently.

In the first case provided an existing interest is disclosed to the other party and no objection is raised by him, the appointment of an interested arbitrator is valid. For example, many building contracts

provide for reference of disputes between the owner and the builder to the arbitration of the architect of the engineer, and many a government contract provides for arbitration by a Government officer. In these cases the interest is known to the other side and the Bombay High Court in *Central Government v. Chhotalal*⁵ has upheld the validity of such a clause. An interest which arises subsequently must be disclosed at once to the other side, otherwise the arbitrator will be guilty of misconduct.

Generally, arbitrators are selected on the ground either of their capacity, technical knowledge or friendship or mutual confidence of the parties to the arbitration agreement. The arbitration agreement itself generally appoints and names the arbitrator or arbitrators. The matter may preferably be referred to a single arbitrator, but as in frequently the case, two or more arbitrators are appointed, each party selecting an arbitrator of his own choice. Though there is no legal objection to this course, from a practical standpoint it is always preferable to select a single arbitrator as far as possible; otherwise the tendency is for each arbitrator to look upon himself as an advocate of the party selecting him. If more than one arbitrator is appointed a provision should also be made in the arbitration agreement for the appointment of an umpire who could act, in case the arbitrators disagree, and more preferably the umpire may also be named. Sometimes it is provided that the arbitrators themselves may select their own umpire in case they disagree. No particular method of appointment of an umpire is prescribed by the Act. Arbitrators who are required to appoint an umpire are under no obligation to obtain the approval of the choice of the personnel by the parties who appointed the arbitrators.⁶

It may also happen that the party to an arbitration agreement may agree that the reference shall be to an arbitrator or arbitrators to be appointed by a person designated in the arbitration agreement and such a person may be designated either by name or as the holder for the time being of any office or appointment, (S. 4) as, for example, the President of the Indian Merchants Chamber, a particular Judge hearing a matter or the Chief Engineer of the Municipality. In contracts with various associations the parties are required to select their arbitrators from a panel of arbitrators appointed by the association.

⁵ Bom. L. R. 615

⁶ *K.D. Kapadla v. Indian Engineering Co.* (1971) 2 S.C.C. 706

It may be added here that *the authority of an appointed arbitrator or umpire is irrevocable except with leave of the Court, unless the agreement itself provides otherwise (S. 5).*

An arbitration agreement is not terminated by the death of any party, either as respects the deceased or any other party, but is enforceable by or against the legal representative of the deceased, to the same extent as any other contract, *i.e.* in all cases except where the cause of action is extinguished by the death of the person. If a party to the arbitration proceedings dies pending the proceedings and the right to sue survives to or against his legal representative, the arbitration agreement will not be discharged, for it can be enforced by or against such legal representative. As Russell puts it; "An arbitration agreement will bind not only the actual parties to it, but also an assignee of a contract containing it, the personal representatives of a deceased party a trustee in bankruptcy who adopts a contract containing it, and generally all persons claiming under a party to it but not strangers to the agreement".

On the same principle the authority of an arbitrator is not revoked by the death of any party by whom he was appointed (S. 6). Where, however, one of the parties to an arbitration agreement becomes *insolvent* and it is provided by a term in such an agreement that the differences arising shall be referred to arbitration and if the receiver adopts this agreement, the said arbitration agreement shall be enforceable by or against him as far as it relates to any such differences [S. 7(1)]. In such a case where such a rule does not apply, the Court may if it is of the opinion that the other party to the agreement or the receiver on the insolvency of one of the parties to the arbitration agreement may, apply to the Court having jurisdiction in insolvency proceedings for an order directing that the matter in question shall be referred to arbitration in accordance with the agreement. In such a case, the Court may, if it is of the opinion that, having regard to all the circumstances of the case, the matter ought to be determined by arbitration, make an order accordingly [S. 7(2)] Here the receiver includes an Official Assignee.

Again, where an arbitration agreement provides that the reference shall be to *two arbitrators*, one to be appointed by each party, and each one of the appointed arbitrators neglects or refuses to act or is incapable of acting, or dies, the party who appointed him can appoint a new arbitrator in his place. If one party fails to appoint an arbitrator, either originally or by way of substitution, as in the case mentioned above for fifteen clear days after the service by the other

party of a notice in writing to make the appointment, such other party having appointed his arbitrator before giving the notice, the party who has appointed an arbitrator may appoint that arbitrator to act as sole arbitrator in the reference and his award shall be binding on both parties, as if he had been appointed by consent. This is, of course, is subject to the condition that the Court may set aside any appointment as sole arbitrator or may on sufficient cause being shown, allow further time to the defaulting party to appoint an arbitrator or pass such other order as it thinks fit (S. 9). If there is a provision in an arbitration agreement for the appointment of *three arbitrators* and it is stated that the two parties shall appoint one arbitrator for each of them and that the third arbitrator shall be selected by the two arbitrators appointed by the parties, the appointment of the third arbitrator shall have the same effect as if the provision was for the appointment of an umpire and not that of a third arbitrator [S. 10 (1)]. Where, however, the arbitrator agreement provides that the reference shall be to three arbitrators to be appointed otherwise than as mentioned in Section 10 (1), the award of the majority of the arbitrators, unless the arbitration agreement otherwise provides, shall prevail. Where more than three arbitrators are provided by the agreement, the award either of the majority, or in case they are equally divided, the award of the umpire shall prevail, unless the agreement otherwise provides [S. 10 (2)].

Power of Court to Appoint Arbitrators

This is laid down in Section 8 of the Arbitration Act of 1940 the effect that, *where any of the parties fails to make an appointment, the Court has power to appoint arbitrators in the case of a private arbitration by agreement in the following cases:—*

(a) where an arbitration agreement provides that the reference shall be to one or more arbitrators to be appointed by consent of the parties, and all the parties do not, after differences have arisen concur in the appointment or appointments; or

(b) If any appointed arbitrator or umpire neglects or refuses to act, or is incapable of acting, or dies and the arbitration agreement does not show that it was intended that the vacancy should not be supplied, and the parties or the arbitrators, as the case may be, do not supply the vacancy; or

(c) where the parties or the arbitrators are required to appoint an umpire and do not appoint him. In such a case where the appointment by the Court is made, any party may serve the other

parties or the arbitrators, as the case may be, with a written notice to concur in the appointment or appointments or in supplying the vacancy, and in spite of that notice, if the appointment is not made within 15 clear days after the service of notice, the Court may, on application by the party giving the notice and after giving an opportunity to the other parties of being heard, appoint an arbitrator, or arbitrators or umpire, as the case may be. These appointees shall have like power to act in the reference and to make an award as if they have been appointed by consent of all parties [S. 8].

According to the proper construction of the section, when the agreement is silent as regards supplying the vacancy, the law presumes that the parties intended to supply the vacancy. To take the case out of S. 8 (1) (b) what is required is not the intention of the parties to supply the vacancy but their intention not to supply.⁷

Powers and Duties of Arbitrators

The powers of an arbitrator or umpire, *subject to an agreement to the contrary*, are the following—

- (a) administer oath to the parties and witnesses appearing;
- (b) state a special case for the opinion of the Court on any question of law involved, or state the award, wholly or in part, in the form of a special case of such question for the opinion of the Court;
- (c) make the award conditional or in the alternative;
- (d) correct in an award any clerical mistake or error arising from any accidental slip or omission;
- (e) administer to any part to the arbitration such interrogatories as may, in the opinion of the arbitrators or umpire, be necessary (S. 1).

The duty of an arbitrator is to act with impartiality. He should have no personal interest in the matter in dispute, but if he happens to be an interested party, of which the parties had notice at the time of appointment, the arbitration agreement would be good. He should also see that he accepts no hospitality from any of the parties to the reference. If it is proved to the satisfaction of the Court that the effect of his accepting hospitality was to bias his mind in favour of the parties offering such hospitality, the Court will interfere to set aside the award. It has also been held that *the authority of the arbitrator commences from the moment of time he begins with the business of reference and not from the time of his appointment.*⁸ It is also the duty of an arbitrator to consult the con-

⁷ Shab, Hegde and Grover JJ., *M/s Prabhat General Agencies v. Union of India* (1971) S. C. D. 4

⁸ *Baker v. Stephen*, L. R. Q. B. 523

venience of the parties as far as possible. The *proceedings* before the arbitrator should be *in the form, as far as possible, of a suit*, and the party in the position of the plaintiff in a civil suit, must begin. The parties have a right to appear in person or to be represented by a legal adviser. It is, however, necessary *that the party proposing to be represented by a counsel or a pleader must give the opposite party notice to the effect so that the other party may also make its own arrangements, if it so chooses.*⁹ In this case the Court interfered because the arbitrator refused to adjourn a meeting to enable a party to engage a counsel when the other party unexpectedly appeared by counsel. After the party in the position of the plaintiff has opened the case, and called evidence, the party in the position of the defendant must open the case and call evidence. Next, the defending party must address, to which the party in the position of the plaintiff must respond. A lay arbitrator is allowed to have a legal adviser to sit with him during the proceedings, but such adviser has no power of interference in the arbitration proceedings and his only function is to advise, which advice may not be accepted by the arbitrator. The arbitrator must also see that all the proceedings go on in the presence of the parties or their legal representatives, except where he is justified in acting *ex parte* after due notice, as stated above.

The arbitrator is a judge by the choice of the parties. He is not bound by the provisions of the Evidence Act. He can decide matters as best as he thinks fit. Parties are bound by his award. The *only limitation on the powers of an arbitrator* are that he should not violate the principles of natural justice, he should give a fair hearing to the parties and should give a reasonable time and opportunity to them to substantiate their respective claims.¹⁰

The Award

The award is the written decision of the arbitrator or the umpire. When the arbitrators or umpire have made their award, they must sign it and give *notice in writing* to the parties of the making and signing and of the amount of fees and charges payable in respect of the arbitration and award.

The arbitrators or umpire must, *at the request of any party to the arbitration agreement or any person claiming under such party or if so directed by the Court and upon payment of the fees and charges due in respect of the arbitration and award and of the costs and*

⁹ *Whately v. Morland*, 2 Dowl, 249

¹⁰ *President of India v. Kesar Singh* AIR (1966) J & K 113

charges of filing the award, *cause the award* or a signed copy of it, together with any depositions and documents which may have been taken and proved before them, to be *filed* in Court. The Court will thereupon give notice to the parties of the award. Where the arbitrators or umpire state a special case under Section 13 (b), the Court after giving notice to the parties and hearing them, will pronounce its opinion and such opinion must be added to, and form part of the award (S. 14).

An arbitrator's award on both fact and law is final. There is no appeal from his verdict. The Court cannot review his award and correct any mistake in his adjudication, unless an objection to the legality of the award is apparent on the face of it.¹¹

This is now well settled law and Justice J. C. Shah in *Union of India v. A. L. Rallia Ram*¹² has adequately brought out the position when he said that "the award of the Arbitrator is ordinarily final and conclusive, unless a contrary intention is disclosed by the agreement. The award is the decision of a domestic tribunal chosen by the parties and the civil courts which are entrusted with the power to facilitate arbitration and to effectuate the awards cannot exercise appellate powers over the decision. Wrong or right, the decision is binding, if it be reached fairly after giving adequate opportunity to the parties to place their grievances in the manner provided by the arbitration agreement. But it is now firmly established that an award is bad on the ground of error of law on the face of it, when in the award itself or in a document actually incorporated in it, there is found some legal proposition which is the basis of the award and which is erroneous".

As regards a pure question of fact of the Court cannot sit in judgment over the decision of the arbitrators on such question of fact. The Award cannot be set aside or modified even if there was an error of fact.¹³

Modification or Correction of Award

The Court may modify or remit the award. In the case of modification or correction, the Court interferes where it appears that—

¹¹ *Firm Madanlal Roshanlal Mahajan v. Hukumchand Mills Limited* A.I.R. (1967) S.C. 1030; (1967) I.S.C.R. 105

¹² (1964) 3 S.C.R. 164

¹³ A. I. R. (1967) S. C. 1032 referred. A.I.R. (1971) S.C. 696 relied on. *Damodar Valley Corporation v. INC Co.*, A.I.R. (1972) Cal. 153

(a) *a part of the award is upon a matter not referred to arbitration and such part can be separated from the other part and does not affect the decision on the matter referred; or*

(b) *where the award is imperfect in form, or contains any obvious error which can be amended without affecting such decision; or*

(c) *where there is a clerical error or mistake arising from an accidental slip or omission [S. 15].*

The general rule in matters of arbitration awards is that, where parties have agreed upon an arbitrator thereby displacing a Court of law for a domestic forum they must accept the award as final for good or ill. In such cases the discretion of the Court either for remission or for setting aside the award will not be readily exercised and will be strictly confined to the specific grounds set out in Sections 16 and 30 of the Act.¹⁴

Remittance of Award

In case of remitting an award, the Court will do so.

(a) *where the award has left undetermined any of the matters referred to arbitration or where it determines any matter not referred to arbitration and such matter cannot be separated without affecting the determination of the matters referred, or*

(b) *where the award is so indefinite as to be incapable of execution, or*

(c) *where an objection to the legality of the award is apparent upon the face of it [S. 16(1)].* When the Court remits an award under these circumstances the Court must fix the time within which the arbitrator or umpire should submit his decision to the Court, subject of course, to the extension of the time so fixed by a subsequent order of the Court [S. 16(2)]. Where an award is remitted and the arbitrator or umpire fails to reconsider it and submit his decision within the time fixed, it will become void [S. 16(3)].

Interim Award and Extension of Time

It shall be further noticed that the arbitrators or umpire may make an interim award, *unless the agreement otherwise provides*. The same rules of law prevail under an interim award as under a final award [S. 27]. Where a time for the making of an award is fixed, the Court may, if it thinks fit, before or after the expiry of the said time, and whether or not the award has been made, enlarge from time to time the time for making the award. Any provision in an arbitration

¹⁴ *Allen Berry & Co. (P) Ltd. v. Union of India* (1971) S.C.J. 443

agreement whereby the arbitrators or umpire may, except with the consent of all the parties to the agreement, enlarge the time for making the award is void and of no effect [S. 28].

Setting aside of an Award

Any of the parties dissatisfied with the award may file a petition in the court in which the petition may be fixed within thirty days after receipt of notice from the court that the award has been filed in court. An award may be set aside on the following grounds.—

(a) that an arbitrator or umpire has misconducted himself or the proceedings;

(b) that an award has been made after the issue of an order by the Court superseding the arbitration or after arbitration proceedings have become invalid;

(c) that an award has been improperly procured or is otherwise invalid [S. 30].

It has been held that *misconduct* means neglect of duties or judicial misconduct, not necessarily moral turpitude. In proceedings for setting aside an award, it is not open to the Court to reappreciate the evidence the arbitrator had already appreciated, and to sit in appeal over the conclusions he had arrived at.¹⁵

Misconduct which does not amount to moral turpitude is legal misconduct. In *Bhogilal v. Chitmanlal*¹⁶ the learned judge has said that legal misconduct means misconduct in the judicial sense arising from some honest, though erroneous, breach or neglect of duty and responsibility on the part of the arbitrators causing a miscarriage of justice.¹⁷

For example, the assessment of damages, for breach of contract for a sale of goods, based upon black-market prices has been held to amount to legal misconduct and as vitiating the award.¹⁸

Removal of an Arbitrator or Umpire

The Court may (1) on the application of any party to a reference, remove an arbitrator or umpire who fails to use all reasonable dispatch in entering on and proceeding with the reference and making an award; or (2) remove an arbitrator or umpire who has *miscon-*

¹⁵ Shah, Hegde and Grover, JJ, *State of Orissa v. Kalinga Construction Co.* (1970) 2 S. C.C. 861

¹⁶ 52 Bom. 116

¹⁷ 7 C. W. N. 545

¹⁸ 1951 Cal. 78

ducted himself or the proceedings. The arbitrator or umpire so removed will not be entitled to receive any remuneration in respect of his services [S. 11].

Judgment in terms of Award

Where the Court sees no cause to remit or set aside the award on any of the matters referred to arbitration, the Court will, after the time for making an application to set aside the award has expired, or such application having been made, has been refused, proceed to pronounce judgment according to the award. *On the judgment pronounced a decree shall follow, and no appeal shall lie from such decree*, except on the ground that it is (1) in excess of, or (2) not otherwise in accordance with the award [S. 17]. The Court may, however, pass *interim orders* at any time after the filing of the award, whether notice of the filing has been served or not, on being satisfied by affidavit or otherwise, that the party has taken or is about to take steps to defeat, delay or obstruct the execution of any decree that may be passed upon the award, or that speedy execution of the award is just and necessary. The person on whom such interim orders have been passed may, of course, show cause against such orders and the Court may, on hearing him, pass such further orders as it deems necessary and just (S. 18). Where the award is set aside or becomes void the Court may by order supersede the reference and shall thereupon order that the arbitration agreement shall cease to have effect with respect to the difference referred (S. 19).

(2) ARBITRATION THROUGH COURT WHERE NO SUIT IS PENDING

Where the parties have entered into an arbitration agreement *before the institution of any suit* with respect to the *subject matter of the agreement* and a difference has arisen to which the agreement applies, they may, instead of proceeding as in a case of a reference out of Court, apply to the Court having jurisdiction in the matter that the agreement be filed in Court. The application must be in writing and numbered and registered as a suit.

The Court will then direct notices to be given to all parties to the agreement to show cause why the agreement should not be filed and may order the agreement to be filed after hearing them and shall make an order of reference to the arbitrator or arbitrators appointed by the parties either in the agreement or otherwise. Where the parties agree to the appointment of an arbitrator, the Court will

appoint the same arbitrator. In this case the arbitration proceeds under the Arbitration Act (S. 20).

Where there is a difference or dispute as to the arbitrator's remuneration or costs, or where any arbitrator refuses to deliver the award except on payment of the fees demanded by him. The Court may, on application of the parties, order the delivery of the award on payment of the fee demanded by the arbitrator to the Court and thereafter may order what sum, if any, out of the said amount should be paid to the arbitrator or umpire, which to the Court seems reasonable (S. 38).

(3) ARBITRATION IN SUITS, OR SUBMISSION BY CONSENT IN SUITS

After the parties have filed a suit in a Civil Court in connection with any difference between them, they may, before judgment is pronounced, apply in writing to the Court for an order of reference, in which case the arbitrator shall be appointed in such a manner as may be agreed upon between the parties (Ss. 21 & 22). The Court by order will refer to the arbitrator the matter in reference and in the order specify such terms which the Court thinks reasonable for the making of the award. Once the matter is referred to arbitration the Court shall not deal with such matter, except as allowed by the Arbitration Act (S. 23). Where only some of the parties to the suit wish to refer the matter to arbitration and the others do not, the Court may, provided the matter in which the parties are interested can be separated from the subject-matter of the suit refer it to arbitration (S. 24). The other provisions of the Arbitration Act will apply as far as they can be made applicable to arbitration of this type (S. 25).

Appealable Orders

An appeal shall lie from the following *orders* passed under the Arbitration Act of 1970 *and from no others* to the Court authorized by law to hear appeals—

An order—

- (i) superseding an arbitration;
- (ii) on an award stated in the form of a special case;
- (iii) modifying or correcting an award;
- (iv) filing or refusing to file an arbitration agreement;
- (v) staying or refusing to stay legal proceedings where there is an arbitration agreement;
- (vi) setting aside or refusing to set aside an award.

Provided that the provisions of this section shall not apply to any order passed by a Small Causes Court.

No second appeal shall lie from an order passed in appeal under this section, but nothing in this section shall affect or take away any right to appeal to the Supreme Court (S. 39).

SUMMARY

What Constitutes an Arbitration Agreement

An arbitration agreement stands on the same footing as any other agreement. Consent of the parties is the very essence of arbitration. It binds the parties to the agreement unless it is tainted with fraud, coercion, undue influence, etc.

There must be

- (1) a valid agreement
- (2) in writing
- (3) to submit present or future disputes to arbitration.

No particular form is necessary, nor is it required to be signed by the parties.

Death of a party to the agreement will not operate as a revocation of the agreement and will be enforceable by or against the legal representatives of the deceased, if the right to sue or be sued survives.

Rights of Parties

Before the substantive rights of the parties can come into operation it must be shown that

- (1) there is an agreement between the parties to refer the dispute to arbitration;
- (2) they have appointed an arbitrator or arbitrators or umpire to resolve their dispute;
- (3) any one or more of those arbitrators or umpire have neglected or refused to act or is incapable of acting or has died;
- (4) the arbitration agreement does not show that it was intended that the vacancy should not be filled; and
- (5) the parties or the arbitrators, as the case may be had not supplied the vacancy.

Types of Arbitration

The Act provides for—

- (1) Arbitration without the intervention of a Court (Chapter II).

(2) Arbitration with the intervention of a Court where there is no suit pending (Chapter III).

(3) Arbitration In Suits (Chapter IV).

(1) Arbitration Without Court's Intervention

No litigation must be pending at the time of the making of the award, but the parties may make a valid reference of disputes in a pending suit if they agree to arbitration without the supervision of a Court and withdraw the suit, though a reference is made before such withdrawal.

(2) Arbitration with Court's intervention where no suit is pending

Section 20 (Chapter III) is merely a machinery provision and gives an option to a party to apply under that section instead of under Chapter II. Section 20 does not apply where there is a pending suit which affects the subject matter of the reference to arbitration as it is intended to cover only those cases where the parties without having recourse to litigation have agreed to refer their differences to arbitration.

(3) Arbitration In Suits

(i) All the interested parties to the suit must agree to obtain a reference, and

(ii) the subject matter of the reference must be to any matter in difference between the parties in the suit.

When the above two conditions are satisfied, the application for reference must be made at any time before the judgment is pronounced.

TYPICAL QUESTIONS

1. Define arbitration. When can an award be set aside by the Court?

2. Distinguish between Arbitrator and Umpire.

3. Comment on the following—

An Award is an instrument both of offence and defence and operates as *Res Judicate*.

4. A party to an arbitration agreement challenges the award alleging that a question of law was wrongly referred to the arbitrator and further that the arbitrator wrongly decided the same thereby vitiating the award. Discuss the validity of the charge.

5. The heirs referred to arbitration a dispute regarding the distribution of the property of the deceased. One of the heirs, Mr. X, refused to join in the reference. Despite this, the award allotted to him a share. A decree in terms of the award was passed with X's consent. Can X get the benefit of this decree?

6. Can a partner in a firm submit a dispute relating to the business of the firm to arbitration, compromise a claim by the firm or withdraw suit filed on behalf of the firm so as to bind the firm?
7. What disqualifies a person from being appointed an arbitrator?
8. (a) In what cases can Civil Courts appoint arbitrators? Describe the procedure for such appointment.
(b) Where two arbitrators were appointed and one of them was absent at one only of many sittings, that sitting being an unimportant one, and where the award was given jointly, and one of the parties objected to it, would it be liable to be set aside? Give reasons for your reply.
9. Trace the course of an arbitration from its start to its end.
10. Summarise the powers and duties of an arbitrator as to (a) proceeding ex parte, (b) admitting or rejecting evidence, (c) stating a case upon an incidental point of law, (d) stating his whole award to the Court in the form of a special case.
11. Describe briefly the mode of procedure at a reference. For what purposes and within what limits may the parties or the arbitrator, employ professional assistance?
12. When is an arbitrator bound to file an award made by him in the Court? What is the effect of filing the award in the Court?
13. What power has the Court (a) to enlarge the time for making an award, (b) to set aside an award? Within what time, and in what manner, must an application to set aside an award be made?
14. How can the parties to an arbitration compel the attendance of a material witness? Can an arbitrator order the evidence of a material witness, who is abroad, to be taken on commission? Can an arbitrator himself call and examine a witness if either party objects? If a witness before an arbitrator should give false evidence, would he be liable to any offence, and liable to punishment in any manner?

Chapter 25

TRADE MARKS, PATENTS, DESIGNS AND COPYRIGHTS

TRADE MARKS

IN THE OLD DAYS *under the common law* a person who used a Trade Mark had to prove that it was infringed, and that he was the exclusive prior user of it. This was not easy to do and resulted in expensive as well as vexatious litigation. The object of the Trade Mark was that the trader concerned naturally wished to *distinguish* his goods from those of his rivals, either on account of manufacture or selection, so that some other competitor might not pass off his goods for that of the trader.¹

Definition of a Trade Mark

The English Trade Marks Act, 1938 defines a trade mark as—

“Trade mark” means, except in relation to a certification trade mark, a mark used or proposed to be used in relation to goods for the purpose of indicating, or so as to indicate, a connection in the course of trade between the goods and some person having the right either as proprietor or as registered user to use the mark, whether with or

¹ *In re Australian Wine Importers* (1889), 41 Ch. 278

without any indication of the identity of that person and means in relation to a certification trade mark, a mark registered or deemed to have been registered under Section 37 of this Act [S. 68 (1)].

In India, however, after an amount of delay due to conflicting opinion, with the advance of trade an enactment was ultimately taken in hand known as the *Trade Marks Act* of 1940. The latest Act is the *Trade and Merchandise Marks Act*, 1958 which defines a trade mark as follows—

“*Trade mark*” means

(i) in relation to Chapter X (other than Section 81) a registered trade mark or a mark used in relation to goods for the purpose of indicating or so as to indicate a connection in the course of trade between the goods and some person having the right as proprietor to use the mark; and

(ii) in relation to the other provisions of this Act, a mark used or proposed to be used in relation to goods for the purpose of indicating or so as to indicate a connection in the course of trade between the goods and some person having the right, either as proprietor or as registered user, to use the mark whether with or without an indication of the identity of the person, and includes a certification trade mark registered as such under the provisions of Chapter VIII.

It will thus be seen that a trade mark may be made up of any device, brand, heading, label ticket, or name. Even a signature may be used as a trade mark as is actually done in the business world. Besides that, any word, letter or numeral, or combination of numerals or words or letters, may be used as a trade mark.

Sir Duncan Kerly defines a trade mark as “a symbol which is applied or attached to goods offered for sale in the market, so as to distinguish them from similar goods and to identify them with a particular trader or with his successors as the owners of a particular business, as being made, worked upon, imported, selected, certified or sold by him or them, or which has been properly registered under the Acts as the trade mark of a particular trader”.

Registration of a Trade Mark

The Trade Marks Act provides for the establishment of a Trade Marks Registry with a Head Office and Branch Offices. At the Head Office is to be kept a record called the Register of Trade Marks in which must be entered all registered Trade Marks with the names, addresses and descriptions of the proprietors, notifications of assign-

ments and transmissions, the names, addresses and descriptions of registered users, disclaimers, conditions, limitations and such other matters relating to registered trade marks, as are prescribed [S. 6 (1)]. The Register is divided in two parts—A and B, the register existing at the commencement of the 1958 Act being incorporated in Part A.

The register is to be kept under the control and management of an officer appointed by the Central Government, called the *Registrar of Trade Marks* for the purposes of the Trade Marks Act. This register must be open at all convenient times to the inspection of the public subject to conditions and restrictions as may be prescribed. All questions arising as to the class within which any goods shall fall, will be determined by the Registrar whose decision in this matter is final.

The Act also provides for the establishment of a branch of the Trade Marks Registry to facilitate the registration of trade marks. At this branch a copy of the Register must be kept which shall be open to inspection of the public in the same way.

For the purposes of registration in Part A a trade mark must contain or consist of at least one of the following essential particulars, otherwise it will not be registered—

(a) the name of a company, individual, or firm, represented in a special or particular manner;

(b) the signature of the applicant for registration or some predecessor in his business;

(c) one or more invented words;

(d) one or more words having no direct reference to the character or quality of the goods, and not being according to its ordinary signification, a geographical name or a surname or a personal name or any common abbreviation thereof or the name of a sect, caste or tribe in India;

(e) any other distinctive mark.

A name, signature, or any word, other than such as fall within the descriptions in (a) to (d) above shall not be registrable in Part A of the register except upon evidence of its distinctiveness [S. 9 (1) & (2)].

For the purpose of registration in Part B, a trade mark must, in relation to the goods in respect of which it is proposed to be registered, be distinctive or capable of distinguishing goods with which the proprietor is or may be connected in the course of trade from goods in the case of which no such connection subsists, either generally or, where the trade mark is proposed to be registered sub-

ject to limitations in relation to use within the extent of the registration [S. 9 (4)].

With reference to the word '*distinctive*' as used in the Act it means adapted to distinguish goods with which the proprietor of the trade mark is or may be connected in the course of trade from goods in the case of which no such connection subsists either generally, or where the trade mark is proposed to be registered subject to limitations, in relation to use within the extent of the registration. The proprietor who proposes to register with a view to distinguish own his goods from other goods of the same denomination, should select a trade mark which is inherently distinctive or inherently capable of distinguishing his goods and through the use of it in business or of any other circumstances it is in fact so adapted to distinguish or is in fact capable of distinguishing [S. 9(5)]. The Registrar has to be satisfied on this point before he will accept the trade mark for registration. Thus it will be noticed that a *mark cannot be registered unless it is distinctive* or is capable of distinguishing.

If a trade mark be wholly or partly limited to one or more specified colours, such limitation will be taken into consideration when deciding on its distinctive character. If a trade mark is registered without limitation of colour, it will be deemed to be registered for all colours [S. 10].

Prohibition of Registration of Certain Marks

The Act prohibits the registration of the following marks:—

(1) the use of which would be likely to deceive or cause confusion [S. 11(a)]. In *Hoffmann Law Roche & Co. Ltd. v. Geoffrey Manners & Co. Private Ltd.*,² it was held that there was no reasonable probability of confusion between the words "DROPOVIT" and "PROTO-VIT" either from the visual or phonetic point of view and that it is not necessary that the mark should be intended to deceive or intended to cause confusion. It is its probable effect on the ordinary kind of customers that one has to consider. It is necessary to apply both the visual and phonetic tests. It is also important that the marks must be compared each as a whole. It is not right to take a portion of the word and say that because that portion of the word differs from the corresponding portion of the word in the other case there is no sufficient similarity to cause confusion. The true test is whether the totality of the proposed trade mark is such that it is

² (1970) 2 S. C. J. 621: AIR (1970) S. C. 2062

likely to cause deception or confusion or mistake in the minds of persons accustomed to the existing trade mark; or

(2) the use of which would be contrary to any law for the time being in force [S. 11(b)]; or

(3) which comprises or contains scandalous or obscene matter [S. 11(c)]; or

(4) which comprises or contains any matter likely to hurt the religious susceptibilities of any class or section of the citizens of India [S. 11 (d)]; or

(5) which would otherwise be disentitled to protection in a court [S. 11 (e)]; or

(6) which is identical with or deceptively similar to a trade mark which is already registered in the name of a different proprietor in respect of the same goods or description of goods except where the Registrar is satisfied as to its honest concurrent use or of other special circumstances [S.12 (1) & (3)]. In *K. R. Chinna Krishna Chettiar v. Shri Ambal & Co.*,³ it was held that there is a close affinity of sound between "Ambal" and "Andal". The distinguishing feature of the respondent's mark is "Ambal" while that of the appellant's marks is "Andal". The two words are deceptively similar phonetically. The resemblance between the two marks must be considered with reference to the ear as well as the eye and ocular comparison is not always the decisive test. Therefore, even if there be no visual resemblance between the two marks, that does not matter when there is a close affinity of sound between the words which are distinctive features of the two marks; or

(7) no word which is the commonly used and accepted name of any single chemical compound (as distinguished from a mixture) can be registered as a trade mark in respect of a chemical substance or preparation [S. 13 (1)]; or

(8) which falsely suggests a connection with any living person or a person who died within 20 years before the date of application for registration. Here the Registrar may require the applicant, to furnish the consent in writing of such living person or of the legal representative of the deceased person before proceeding with the application [S. 14].

If separate application for registration are presented of trade marks which are identical or resemble each other in respect of the

³ (1970) I. S. C. J. 23

same goods or description of goods, the Registrar may defer the acceptance of the application bearing a later date until the determination of the proceedings relating to the earlier application [S. 13(2)].

What is a Deceptively Similar Mark?

In order to come to the conclusion whether one mark is deceptively similar to another, the broad and essential features of the two are to be considered. They should not be placed side by side to find out if there are any differences in the design and if so, whether they are of such character as to prevent one design from being mistaken for the other. It would be enough if the impugned mark bears such an overall similarity to the registered mark as would be likely to mislead a person usually dealing with one to accept the other if offered to him. Where it is seen that the packets are practically of the same size, the colour scheme of the two wrappers is almost the same, the designs on both, though not identical, bear such a close resemblance that one can easily be mistaken for the other, the essential features of both being that there is a girl with one arm raised and carrying something in the other with a cow or cows near her and hens or chickens in the foreground, and in the background there is a farm house with a fence, with the word "Gluko Biscuits" in one and "Glucose Biscuits" on the other, occupying a prominent place at the top with a good deal of similarity between the two writings, it is manifest that anyone who has a look at one of the packets today may easily mistake the other if shown on another day as being the same article which he had seen before. If one was not careful enough to note the peculiar features of the wrapper on the plaintiffs' goods, he might easily mistake the defendant's wrapper for the plaintiff's if shown to him some time after he had seen the plaintiffs'. After all, an ordinary purchaser is not gifted with the power of observation of a Sherlock Holmes. There is, therefore, no doubt that the defendant's wrapper is deceptively similar to the plaintiffs' which was registered. This clearly amounted to an infringement of the Plaintiffs' mark.⁴

Associated Trade Marks

If the proprietor of a trade mark claims to be entitled to the exclusive use not only of his trade mark, but also of a part thereof separately as a distinct trade mark, he may do so and get both these, i.e. the original trade mark and the separate part registered

⁴ *Parle Products (P) Ltd. v. J.P. & Co.*, (1972) 1 S.C.W.R.488 (1972) 1 S.C.C.618

as separate associated trade marks each such trade mark satisfying all the conditions applying to an independent trade mark [S. 15 (1) & (2) & S. 16. (2)]. Several trade marks may be registered as a *series* in one registration where the person who wants to register them claims to be the proprietor of those trade marks in respect of the same goods or description of goods which while resembling each other in the material particulars thereof yet differ in respect of—

- (a) statement of the goods in relation to which they are respectively used or proposed to be used, or
- (b) statement of number, price, quality or names or places, or
- (c) other matter of a non-distinctive character which does not substantially affect the identity of the trade mark, or
- (d) colour [S. 15 (3)].

Trade marks which are thus registered in a series will be deemed to be associated trade marks [S. 16 (3)].

The Registrar may require trade marks to be registered as *associated trade marks* in cases where a registered trade mark or one which is the subject matter of an application for registration is identical with another registered trade mark or one which is the subject matter of an application for registration, in the name of the same proprietor in respect of the same goods or description of goods or so nearly resembles it as to be likely to deceive or cause confusion if used by a person other than the proprietor [S. 16 (1)]. The Registrar is empowered to dissolve the association in respect of any associated trade marks if he is satisfied that there would be no likelihood of deception or confusion [S. 16 (4)].

The application has to be made in writing to the Registrar in the prescribed manner for registration in Part A or B. Every application must be filed in the office of the Trade Marks Registry within the territorial limits of which the principal place of business in India of the applicant is situate. In the case of a refusal or conditional acceptance of an application, the Registrar must record in writing the grounds for such refusal or conditional acceptance and the materials used by him in arriving at his decision [S. 18]. The Registrar must cause the application to be advertised after acceptance and may even have it advertised before acceptance in certain circumstances [S. 20].

A person who wishes to *oppose the registration* must give notice in writing in the prescribed manner within 3 months from the date

of the advertisement. Within two months of the receipt of such notice the Registrar must serve the notice on the applicant for registration who must send a counter-statement, of the grounds on which he relies. A copy of this counter-statement, if any, will be served by the Registrar to the person giving the notice of opposition. After hearing the parties and considering the evidence the Registrar will decide whether or not to permit the registration [S.21]. The date of the application will be deemed to be the date of registration [S.23].

Certificate of Registration

When the application for registration is accepted, the Registrar will register the trade mark and issue to the applicant a certificate, in the prescribed form of the registration of the trade mark, bearing the seal of the Trade Marks Registry [S.22(2)].

Duration of Registration

The registration of a trade mark is effective for a period of seven years subject to renewal from time to time.

Effect of Registration

The effect of registration is that *the person so registering a trade mark gets an exclusive right to the use of the trade mark accepted in relation to goods mentioned in the registration*. This right to the exclusive use of a registered trade mark will be deemed to be *infringed* if any one other than the registered proprietor uses it without the permission of the proprietor as uses a trade mark *so identical with or so resembling the registered trade mark as to be likely to deceive or cause confusion* in the course of trade in respect of any goods for which it is registered [S.29(1)]. A person will not be entitled to institute any proceeding to prevent or to recover damages for the *infringement* of an unregistered trade mark [S.27]. However, a *passing off action* in tort can be brought in the case of an unregistered trade mark. It must, however, be noticed that no registration of a trade mark shall interfere with any *bona fide* use by any person of his own name or that of his place of business or of the name of the place of business of any of his predecessors in business or the use of any person of any *bona fide* description of the character or quality of his goods [S.34].

The registration of a trade mark is *prima facie* evidence of its validity [S.31]. Registration in Part A will be conclusive evidence as to its validity after seven years unless it is proved—

(1) that the original registration was obtained by fraud, or
 (2) that the trade mark was registered in contravention or offends against the provisions of S.11 (prohibition of registration of certain marks).

(3) that the trade mark was not at the commencement of the proceedings distinctive of the goods of the registered proprietor [S.32].

Vested rights in other persons who were using similar trade marks are protected by the provisions of Section 33.

Rectification and Correction of the Register

Rectification and correction of the register may be made on application to a High Court or to the Registrar by any person aggrieved. The registered proprietor of a trade mark may apply for rectification for any of the following purposes—

(a) correct any error in the name, address or description of the registered proprietor of a trade mark, or any other entry relating to the trade mark;

(b) enter any change in the name, address or description of the person who is registered as proprietor of a trade mark;

(c) cancel the entry of a trade mark on the register;

(d) strike out any goods or classes of goods from those in respect of which a trade mark is registered;

(e) enter a disclaimer or memorandum relating to a trade mark which does not in any way extend the rights given by the existing registration of the trade mark, [S.57].

Constant User Necessary

The trade mark which is registered is expected by law to be constantly used. If a trade mark is registered without any *bona fide* intention on the part of the applicant to use it in relation to those goods, or if up to one month before the date of the application, for a continuous period of five years or longer, prior to the period of application, the trade mark, though registered, was not used in relation to the goods concerned, it is likely to be taken off the register on application to a High Court or to the Registrar (S.46).

Assignment of Registered Trade Marks

The proprietor of a registered trade mark has a right to assign it subject to the provisions of the Trade Marks Act to any other person and to give effectual receipts for any consideration for such assignment. This consideration may or may not be in connection with the goodwill of a business or in respect of all the goods forms which it is registered or some of such goods (Ss. 36 & 37).

Registered or unregistered trade marks cannot be assigned or transmitted where the result would be the creation of multiple exclusive rights (S.39).

In the case of registered or unregistered trade marks which are assigned otherwise than in connection with the goodwill of the business the assignment will not be effective unless, not later than 6 months from the date of assignment, the assignee applies to the Registrar for directions with respect to the advertisement of assignment, and advertises it as directed by the Registrar. Section 14 provides the registration of assignments and transmission by the person entitled on application and proof of title.

Assignment of Unregistered Trade Marks

Unregistered trade marks are not assignable or transmissible except along with the goodwill of the business concerned.

Provided that an assignment or transmission otherwise than along with goodwill will be permissible, if—

(a) at the time of assignment or transmission of the unregistered trade mark, it is used in the same business as a registered trade mark; and

(b) the registered trade mark is assigned or transmitted at the same time and to the same person as the unregistered trade mark; and

(c) the unregistered trade mark relates to goods in respect of which the registered trade mark is assigned or transmitted (S.38).

Special Provisions for Textile Goods

Special provisions are made by the Act in Chapter IX for textile goods. Trade marks, in respect of textile goods, of which registration had been refused, were to be entered in a list called the Refused Textile Marks List maintained under the Trade Marks Act of 1940. Now after the commencement of the Act of 1958 no addition can be made to this list, but a mark already entered in the Refused Textile Marks List may be continued for a further period of seven years if an application to that effect has been made in the prescribed manner within one year of the commencement of the Act (S 73).

The following *restrictions* are provided for in connection with the registration of textile goods—

(1) In respect of piecegoods.

(a) no mark consisting of a line heading alone shall be registrable as a trade mark;

(b) a line heading shall not be deemed to be adapted to distinguish;

(c) the registration of a trade mark shall not give any exclusive right to the use of a line heading.

(2) In respect of any textile goods, the registration of letters or numerals, or any combination thereof, shall be subject to such conditions and restrictions as may be prescribed (S. 72).

Section 74 prescribes the stamping of piece goods, cotton yarn and thread while Section 75 empowers the Central Government to make rules for the determination of the character of textile goods by sampling.

Offences under the Trade Marks Act

The Trade Marks Act provides for punishment of penalty for

- (1) Falsifying and falsely applying trade marks (S. 77).
- (2) Applying false trade marks, trade descriptions etc. (S. 78).
- (3) Selling goods to which a false trade mark or false trade description is applied (S. 79)
- (4) Removing piece goods, etc., contrary to Section 74 (S. 80).
- (5) Falsely representing a trade mark as registered (S. 81).
- (6) Improperly describing a place of business as connected with the Trade Marks Office (S. 82).
- (7) Falsification of entries in the Register (S. 83).

The Trade Marks Act also contains provisions for the forfeiture of goods in certain cases (S. 85).

PATENTS

The Statute in force today is the Patents Act, 1970, which came into force on April 20, 1972. The previous statute was the Patents and Designs Act, 1911, which provided for registration not only of patents but also of designs. The provisions of the 1911 Act so far as they related to patents have been replaced by the Patents Act, 1970; the remaining provisions of the Patents and Designs Act, 1911 continue to be in force and that Act is now known as the Designs Act, 1911. The main changes effected by the new legislation are to shorten the period of registration of patents and to provide for easier machinery for compulsory licensing of patents.

What is a Patent ?

The Patent Right is virtually speaking *the grant of a monopoly in respect of an invention by the Crown or the Government.* In olden

days, the Kings of England gave these monopolies. Later, certain restrictions were placed by the Statute of Monopolies 1623 by creating a control on the free and unrestricted right of the Crown to give monopolies. The word "*Patent*" came into use and was derived from the fact that the *form* in which the patent right was granted was known in Latin as *Litterae Patents*, i.e. open letters were addressed "to all to whom it may concern". The English Law is to be found in the Acts of 1907, 1914, 1919, 1920, 1932, 1938, 1939, 1942 and 1946 but as the later acts are more or less amendments of the main Act of 1907, the consolidated Acts of England are now cited as the "Patents and Designs Act, 1907 to 1946".

What are Not "Invention"

The following are not "Invention" under the Act—

(1) An invention that is frivolous or which claims any thing that is obviously contrary to well-established natural laws.

(2) An invention, the use of which would be contrary to law or morality or injurious to public health.

(3) A mere discovery of a scientific principle or a formulation of an abstract theory.

(4) A mere discovery of any new property, or a new use for a known substance or a mere use of a known process, unless such a known process results in a new product.

(5) A mere arrangement or rearrangement or duplication of known devices, all functioning independently of one another in a known manner.

(6) A substance obtained by a mere admixture resulting only in the aggregation of the properties of the components thereof or a process for producing such substance.

(7) A method of agriculture or horticulture.

(8) Any process for the medicinal, surgical, curative, prophylactic or other treatment of human beings or any process for a similar treatment of animals or plants to render them free of disease or to increase their economic value or that of their products (S. 3).

Inventions Where only Methods or Processes of Manufacture are Patentable

(1) In the case of inventions claiming substances used for, or capable of being used as, food, medicine or drug; or

(2) relating to substances prepared or produced by chemical processes, only the method of process or manufacture can be patentable, and no patent can be granted for the invention itself [S. 5].

In the case of inventions relating to baby and invalid food, medicines and drugs, it would not be in the interests of an under-developed country like India to grant patents in respect of the substances themselves. But there is no such objection in relation to the processes involved and also in relation to substances when produced by such processes.⁵

Application for Grant of Patent

An application for the grant of a patent must be made in the prescribed form, to the Patent Office and the said application *should declare* that the applicant, or where there is a joint application of more than one, atleast one of the applicants, was the true and first inventor or the legal representative or assignee of such inventor and for which invention he desires to obtain a patent. The application must be accompanied by either a provisional or complete *specification of the invention* and by the prescribed fee [S. 3]. A provisional specification must describe the nature of the invention. A complete specification must particularly describe and ascertain the nature of the invention and the manner in which it is to be performed and shall be filed within twelve months from the date of filing of the application, and if the complete specification is not so filed the application shall be deemed to be abandoned [S. 9]. A specification, whether provisional or complete must commence with the title, and in the case of a complete specification must end with a distinct statement, of the invention claimed. It is also provided that where desired by the Controller a drawing of the invention has to be prepared and submitted. The Controller may even, where he thinks desirable, ask for a model or sample of anything illustrating the invention [S. 10].

Examination of Application

Chapter IV deals with the examination of the application. The Controller refers the application and the specification relating thereto to an examiner, who makes a report to him after considering—

- (i) that the requirements of the Act are complied with;

⁵ Statement of Objects and Reasons

- (ii) whether there is any lawful ground of objection to granting of the patent; and
- (iii) the result of investigation under Sec. 13.

This Report shall be made by the Examiner ordinarily in 18 months [S. 12].

Sections 15 to 20 of the Act deal with the different powers of the Controller.

Opposition to Grant of Patent

Any person on payment of a certain fee may at any time *within four months from the date of the advertisement of the acceptance* of the application give notice to the Patent Office of the opposition to the grant of the patent. This opposition may be on any of the following grounds:—

- (a) that the applicant for the patent or the person under or through whom he claims, wrongfully obtained the invention or any part thereof from him or from a person under or through whom he claims;
- (b) that the invention so far as claimed in any claim of the complete specification has been published before the priority date of the claim—
 - [i] in any specification filed in pursuance of an application for a patent made in India on or after the 1st day of January, 1912; or
 - [ii] in India or elsewhere, in any other document;
- (c) that the invention so far as claimed in any claim of the complete specification is claimed in a claim of a complete specification published on or after the priority date of the applicant's claim and filed in pursuance of an application for a patent in India, being a claim of which the priority date is earlier than that of the applicant's claim;
- (d) that the invention so far as claimed in any claim of the complete specification was publicly known or publicly used in India before the priority date of that claim;
- (e) that the invention so far as claimed in any claim of the complete specification is obvious and clearly does not involve any inventive step; having regard to the matter published as mentioned in clause (b) or having regard to what was used in India before the priority date of the applicant's claim;
- (f) that the subject of any claim of the complete specification is not an invention within the meaning of this Act, or is not patentable under this Act;
- (g) that the complete specification does not sufficiently and clearly describe the invention or the method by which it is to be performed;
- (h) that the applicant has failed to disclose to the Controller the information required by Section 8 or has furnished the information which in any particular material was false to his knowledge;
- (i) that in the case of a convention application, the application was not made within twelve months from the date of the first application for protection for the

invention made in a convention country by the applicant or a person from whom he derives title; but no other ground [S 25].

In case of the *refusal of the Controller to accept* the application there is a *right of appeal from his decision* to the High Court [S.116]. It may be further noted that unless an application or a complete specification is accepted within fifteen months from its date the application will be deemed to have been abandoned unless an appeal has been lodged [S.21].

Where the application is accepted an advertisement must be given by the Controller of his acceptance keeping the specifications and drawings, if any, open for public inspection (S.26).

After the acceptance of the patent whether opposed or unopposed the patent will be granted to the application under seal of the Patent Office. *The date of the patent will be the date on which the complete specification is filed* (S.45).

A patent obtained in fraud of a true and first inventor may be removed and a new patent may be granted to the rightful owner, inventor or assignee (S.52).

Term of Patents

The term for which a patent is granted is provided in (S.63)

The term for every patent granted shall—

(i) in respect of an invention claiming the method or process of manufacture of a substance, where the substance is intended for use, or is capable of being used, as food or as a medicine or drug be five years from the date of sealing of the patent, or seven years from the date of the patent, whichever period is shorter; and

(ii) in respect of any other invention, be fourteen years from the date of the patent.

A patent shall cease to have effect on the expiration of the period prescribed for the payment of any renewal fee, if that fee is not paid within the prescribed period.

Patents of Addition

Provisions relating to Patents of Addition are contained in Chapter IX of the Act.

Where an application is made for a patent in respect of any improvement in or modification of an invention described or disclosed in the complete specification filed therefor (referred to as the "main invention" in the Act) and the applicant also applies or

has applied for a patent for that invention or is the patentee in respect thereof, the Controller may, if the applicant so requests, grant the patent for the improvement or modification as a patent of addition (S.54).

A patent of addition shall be granted for a term equal to that of the patent for the main invention, or so much thereof as has not expired, and shall remain in force during that term or until the previous cesser of the patent for the main invention and no longer (S.55).

Restoration of Lapsed Patent

A patent may lapse due to the failure of the patentee to pay the fee prescribed within the time appointed, but the same may be restored on an application to the Controller within one year from the date on which the patent ceased to have effect, stating the circumstances which led to the omission of the payment of the prescribed fee (S.60). If the Controller finds that the omission was unintentional or unavoidable and that there was no undue delay in the making of the application for restoration, he may advertise the application and after the expiration of the prescribed period hear the case and, subject to an appeal to the High Court, may issue an order restoring the patent subject to any conditions or restrictions deemed advisable (S.61).

Register of Patents

At the Patent Office a book called the Register of Patents shall be kept in which all the names and addresses of the grantees of patents are entered together with notifications of assignments and transmissions of the said patents or amendments, extensions and revocations. The Register will also include information regarding licences under patents and such other matters affecting the validity of proprietorship of patents as may be prescribed (S.67).

Effect of Patents

The effect of a patent sealed with the seal of the Patent Office is that it gives the patentee the exclusive privilege of making, selling and using the invention or method, or process of manufacturing an article by himself, his agent or licensees throughout India (S.48). Of course, this right is subject to the other provisions of the Act. The patent has to all intents the like effect as against the Government as it has against any person. Chapter XVII of the Act, however also provides the manner in which the Government

may use the patented invention. However, the proprietor of the patent has a right to assign it to the Central Government in India for consideration as agreed between the parties, or determined by the High Court (S.210).

Compulsory Licences

Any time *after three years* from the sealing of a patent, an application may be made by any person interested to the Controller, alleging that the reasonable requirements of the public with respect to the patented invention have not been satisfied, or that the patented invention is not available to the public at a reasonable price and praying for the grant of a compulsory licence to work the patented invention (S. 84). The following are the *grounds* that the Controller shall take into account when an application under S. 84 for the grant of a licence is made —

(i) the nature of the invention, the time which has elapsed since the sealing of the patent and the measures already taken by the patentee or any licensee to make full use of the invention;

(ii) the ability of the applicant to work the invention, to the public advantage ;

(iii) the capacity of the applicant to undertake the risk in providing capital and working the invention, if the application were granted;

but shall not be required to take into account matters subsequent to the making of the application. [S. 85].

Endorsement of Patent with the Words “Licences of Right”

At any time after the expiration of three years from the date of sealing of a patent, the Central Government may make an application to the controller for an order that the patent may be endorsed with the words “Licences of Right” on the ground that the reasonable requirements of the public with respect to the patent invention have not been satisfied or that the patent invention is not available to the public at a reasonable price.

The Controller, if satisfied that the reasonable requirements of the public with respect to the patented invention have not been satisfied or that the patented invention is not available to the public at a reasonable price, may make an order that the patent be endorsed with the words “Licences of Right” [S. 86].

Section 87 provides that substances which are used or are capable of being used as food, medicine or drug or the method or process of manufacture of any of these substances shall be deemed to be endorsed with the words “Licences of Right”.

DESIGNS

Designs may also be registered by an *application to the Controller* and such registered design may be in more than one class. The *certificate of registration* shall be given for the designs by the Controller and a *register* has to be maintained for designs also as in the case of patents.

A “*design*” is defined by Section 2 (5) of the Designs Act, 1911, as—

“*design*” means only the nature of shape, configuration, pattern or ornament applied to any article by any industrial process or means, whether manual, mechanical, or chemical separate or combined, which in the finished article appeal to and are judged solely by the eye; but does not include any mode or principle of construction or anything which is in substance a mere mechanical device, and does not include any trade mark as defined in Clause (V) of Sub-Section (1) of Section 2 of the Trade and Merchandise Marks Act, 1958, or property mark as defined in Section 479 of the Indian Penal Code.

The registered proprietor of the design gets a *copyright* in the design during *five years* from the date of registration. Applications for extension for further periods of five years must be made before the expiration of the period of the last registration [S. 47].

An application by any person interested may be made for *cancellation* of the registration. This application may be made, at any time after registration of the design, to the High Court on the following grounds:—

- (i) that the design has been previously registered in India;
- (ii) that it has been published in India prior to the date of registration; or
- (iii) that the design is not a new or original design.

Such an application may also be made to the Controller provided it is made within one year from the date of the registration and is based on either of the grounds (i) and (ii) given above [S. 51A].

Piracy of Registered Design

During the existence of copyright in any design it shall not be lawful for any person—

(i) for the purpose of sale to apply or cause to be applied to any article in any class of goods in which the design is registered the design or any fraudulent or obvious imitation thereof, except with the license or written consent of the registered proprietor, or to anything with a view to enable the design to be so applied;

(ii) to import for the purpose of sale without the consent of the registered proprietor, any article belonging to the class in which the design has been registered and having applied to it the design or any fraudulent or obvious imitation thereof; or

(iii) knowing that the design or any fraudulent or obvious limitation thereof has been applied to any article in any class of goods in which the design is registered without the consent of the registered proprietor, to publish or expose or cause to be published or exposed for sale that article [S. 53].

COPYRIGHTS

The Copyright Act of 1957 now amends and consolidates the law relating to copyright in India and extends to the whole of India.

International Copyright

The law as to copyright was in a state of confusion until the passing of the Copyright Act of 1911 in England. Our Indian Copyright Act of 1914 was based on that Act. Even before the passing of these Acts in order to protect the rights of authors over their literary and artistic works, a number of countries, including the U. K., formed themselves into a union known as the *Berne Convention*. This was revised first at Rome in 1928 and then at Brussels in 1948 when the Brussels Convention was signed by a much larger number of countries including India.

In view of the numerous technical developments that had been taking place throughout the world in regard to gramophone records, talking films, broadcasting, television, etc., the *Copyright Committee* was set up in England and on its recommendations the Copyright Act of 1956 was passed in England. In passing this Act, the interests of the author and of the public were borne in mind and the Indian Act of 1957 which came into force on January 21, 1958 also attempts to provide for all these problems.

The *Universal Copyright Convention* held under the auspices of UNESCO adopted the following principle expressed in Article II—

“(1) Published works of nationals of any contracting State and works first published in that State shall enjoy in each other contracting State the same protection as that other State accords to works of its nationals first published in its own territory.

(2) Unpublished works of nationals of each contracting State shall enjoy in each other contracting State the same protection as that other State accords to unpublished works of its own nationals.”

India also signed this convention and brought it into effect from January 21, 1958.

Under the *Universal Copyright Convention*, in order to secure copyright protection in the countries which have signed the Con-

vention, all that is required is that the letter C in a circle, thus © should appear on all the copies of the work in a prominent place together with the name of the owner of the copyright and the year of first publication.

By Sections 40 & 41 of our Act the Central Government is empowered to extend copyright to foreign works and this power has been exercised by means of the International Copyright Order 1958⁶ which applies the provisions of our Copyright Act, 1957 to works first published in any of the Berne Convention Countries as well as to any of the Universal Copyright Convention Countries.

By the Copyright (International Organization) Order, 1958 copyright in India is given to the works of (a) the United Nations Organization, (b) Specialised Agencies of the United States Organisation and (c) the Organisation of American States.

Nature and Scope of Copyright

Copyright subsists under the Act throughout India in original literary, dramatic, musical and artistic works, cinematograph films, and records.

(i) in the case of a published work if the work is first published in India or where it is first published outside India, the author is at the date of such publication, or if the author was dead at that date, was at the time of his death, a citizen of India.

(ii) in the case of an unpublished work other than an architectural work of art, the author is at the date of the making of the work a citizen of India or domiciled in India, and

(iii) in the case of an architectural work of art, the work is located in India (S.13).

Copyright is defined by Section 14 as follows:-

(1) For the purpose of this Act, 'copyright' means the exclusive right, by virtue of, and subject to the provisions of, this Act—

(a) in the case of a literary, dramatic or musical work, to do and authorise the doing of any of the following acts, namely—

(i) to reproduce the work in any material form;

(ii) to publish the work;

(iii) to perform the work in public;

(iv) to produce, reproduce, perform or publish any translation of the work;

(v) to make any cinematograph film or a record in respect of the work;

⁶ S.R.O. No 271 dated January 21, 1958

- (vi) to communicate the work by radio diffusion or to communicate to the public by a loud-speaker or any other similar instrument the radio-diffusion of the work;
- (vii) to make any adaptation of the work;
- (viii) to do in relation to a translation or an adaptation of the work any of the acts specified in relation to the work in clauses (i) to (iv).
- (b) in the case of an artistic work, to do or authorise the doing of any of the following acts, namely—
 - (i) to reproduce the work in any material form;
 - (ii) to publish the work;
 - (iii) to include the work in any cinematograph film;
 - (iv) to make any adaptation of the work;
 - (v) to do in relation to an adaptation of the work any of the acts specified in relation to the work in clauses (i) to (ii).
- (c) in the case of cinematograph film, to do or authorize the doing of any of the following acts, namely—
 - (i) to make a copy of the film;
 - (ii) to cause the film, in so far as it consists of visual images, to be seen in public and, in so far as it consists of sounds, to be heard in public;
 - (iii) to make any record embodying the recording in any part of the sound track associated with the film by utilising such sound track.
 - (iv) to communicate the film by radio-diffusion;
- (d) in the case of a record, to do or authorize the doing of any of the following acts by utilising the record, namely—
 - (i) to make any other record embodying the same recording;
 - (ii) to cause the recording embodied in the record to be heard in public;
 - (iii) to communicate the recording embodied in the record by radio-diffusion.

(2) Any reference in sub-section (1) to the doing of any act in relation to a work or a translation or an adoption thereof shall include a reference to the doing of that in relation to a substantial part thereof (S.14).

There is no copyright under the Copyright Act of 1957 in any design which is registered under the Indian Patents and Designs Act, 1911. Copyright in any design, which though capable to being registered under the Indian Patents and Designs Act, 1911, has not been so registered, shall cease as soon as any article to which the design has been applied has been reproduced more than fifty times by an industrial process by the owner of the copyright or, with his licence, by any other person [S.15].

It should be noted that now there is no copyright except as provided by the Copyright Act of 1957 [S.16].

In this connection it should be noted that the copyright is conferred in respect of published or unpublished original literary,

dramatic musical and artistic work. *Ideas and opinions are not the subject of copyright but only the form* in which such ideas or opinions are expressed are subject to copyright and that too to the extent that a *substantial part* of the form must not be copied.

Literary Work

The copyright in the case of 'literary work' is strictly confined to the literary composition of the author and not his ideas or opinion. Among literary works are *included* tables and compilations. The name or title of the book is, generally speaking, not the subject of copyright unless the title also constitutes a literary composition within the meaning of law.

Dramatic Work

"*Dramatic work*" includes any piece for recitation, choreographic work or entertainment in *dump show*, the scenic arrangement or acting form of which is fixed in writing or otherwise but does not include a cinematograph film [S.2(h)].

Musical Work

"Musical work" means any combination of melody and harmony or either of them, printed reduced to writing or otherwise graphically produced or reproduced [S.2(p)].

Artistic Work

"Artistic work" means,—

- (1) a painting, a sculpture, a drawing (including a diagram, map, chart or plant), an engraving or a photograph, whether or not any such work possesses artistic quality;
- (2) an architectural work of art; and
- (3) any other work of artistic craftsmanship [S.2(c)].

Architectural Work

"Architectural work of art" means any building or structure having an artistic character or design, or any model of such building or structure [S.2(b)].

Infringement of Copyright

We have just seen while dealing with the meaning of copyright in Section 14 that it means the exclusive right of doing certain acts in relation to the following four classes of work—

- (1) Literary, dramatic or musical work,
- (2) Artistic work,
- (3) Cinematograph Film,
- (4) Record.

Infringement therefore will be doing of anything in relation to these works which someone else has the exclusive right to do under the Copyright Act. Section 51 states that copyright in a work shall be deemed to be infringed—

(a) when any person, without a licence granted by the owner of the copyright or the Registrar of Copyrights under this Act or in contravention of the conditions of a licence so granted or of any condition imposed by a competent authority under this Act—

- (i) does anything, the exclusive right to do which is by this Act conferred upon the owner of the copyright, or
- (ii) permits for profit any place to be used for the performance of the work in public where such performance constitutes an infringement of the copyright in the work unless he was not aware and had no reasonable ground for believing that such performance would be an infringement of copyright; or

(b) when any person—

- (i) makes for sale or hire, or sells or lets for hire, or by way of trade displays or offers for sale or hire; or
- (ii) distributes either for the purpose of trade or to such an extent as to affect prejudicially the owner of the copyright; or
- (iii) by way of trade exhibits in public, or
- (iv) imports (except for the private and domestic use of the importer) into India

any infringing copies of the work.

Explanation: For the purposes of this section, the reproduction of literary, dramatic, musical or artistic work in the form of cinematograph film shall be deemed to be an “infringing copy”.

Term of Copyright

The term of copyright in literary, dramatic, musical or artistic works (except photographs) published within the lifetime of the author is until *fifty years* from the beginning of the calendar year (*i.e.* from January 1) next following year in which the author dies. In the case of *joint authorship*, the above reference to “the author” will apply to the joint author who dies last [S. 22]. The term of copyright in *anonymous or pseudonymous* works is until fifty years from the beginning of the calendar year next following the year in which the work is first published, but if the identity of the author is revealed before the expiry of that period the copyright will subsist

until fifty years from the beginning of the next calendar year following the year in which the author dies [S. 23].

In the case of a *posthumous* work, *i.e.* work published after the death of the author, the copyright will subsist until fifty years from the beginning of the next calendar year following the year in which the work is first published [S. 24].

In the case of a *photograph* the term is fifty years from the time the photograph is published and not from the date when it is taken [S. 25]. Similarly the term is fifty years from the date it is published in the case of a *cinematograph* film [S. 26] *record* [S. 27]. *Government work and works of international organizations* [S. 29].

Registration of Copyright

Provision is now made for the establishment of a copyright office under the immediate control of the Registrar of Copyright who must act under the superintendence and direction of the Central Government. Registration is *optional* but to encourage it, it is provided that no proceeding regarding infringement of the copyright can be instituted unless the copyright is registered in the copyright office. The Register of Copyright is only *prima facie* evidence of the particulars entered therein [S. 48]. The duties of the Registrar include the right to deal with applications for compulsory licences. An appeal may be made to the Copyright Board against an order of the Registrar.

Ownership of Copyright

Generally, the first ownership in copyright is in the author of the work except in the following cases:—

(a) in a literary, dramatic or artistic work made by the author in the course of his employment in a newspaper, magazine or similar periodical under a contract of service or apprenticeship, the first ownership of the copyright will be in the proprietor of such newspaper, etc. for the purpose of its being so published.

(b) subject to (a) above, in the case of a photograph taken, or a painting or portrait drawn, or an engraving or cinematograph film made, for valuable consideration at the instance of any person, such person will be the first owner of the copyright unless there is a contract to the contrary.

(c) in the case of a work made in the course of the author's employment under a contract of service or apprenticeship to which

(a) and (b) above do not apply, the employer will be the first owner of the copyright unless there is an agreement to the contrary.

(d) in the case of a Government work the Government will be the first owner of the copyright in the absence of any agreement to the contrary.

(e) in the case of works of certain international organisations, to which Section 41 applies the international organisation concerned will be the first owner of the copyright [S. 17].

Translation

The right of translation is in the owner of the copyright but the Copyright Board may issue a licence for translation if the owner does not publish or authorise the publication of a translation or if such publication is out of print.

Assignment of Copyright

The owner of the copyright is entitled to assign it wholly or partially but if the assignment relates to a future work, the assignment will take effect only when the work comes into existence [S. 18]. The assignment, in order to be valid, must be in *writing, signed* by the assignor or his duly qualified agent [S. 19]. Registration is not necessary as copyright is movable property and Section 54 of the Transfer of Property Act does not apply.⁷

Assignment must be *distinguished from licence*. In the case of an assignment, the copyright itself is transferred whereas in the case of a licence, the copyright belongs to the licensor who merely permits certain things to be done by the licensee which would be illegal if done without such permission. Thus the assignee may sue in his own name for infringement of the copyright but the licensee cannot as he is not the owner of the copyright. Another point of difference is that as an assignment transfers a specific interest of the assignor wholly or partially in the thing the assignee may re-assign the copyright but a licence is only personal, and cannot be assigned by the licensee without the licensor's permission.

Licence

Licences may be granted (a) either by the owner of the copyright [S. 30] or by the Registrar when directed by the Copyright Board (S. 31). The licence must be granted in *writing*. The granting of a licence conveys a privilege to do what would otherwise be a

⁷ *Savitri Devi v. Dwarka Prasad* (1939) A.I.R. All 305

monopoly of the grantor. If the licence is granted subject to certain conditions, it will amount to an infringement of the copyright if the conditions are not observed. In the case of a *Compulsory licence* a complaint must be received by the *Copyright Board* to the effect that the owner had been approached for the grant of a licence but that he had refused to do so and withheld work from the public as provided by Section 31. This applies only in the case of an Indian work and reasonable compensation will be given to the owner. We have also seen that a compulsory licence may be granted by the Copyright Board for a translation if the owner of the copyright does not publish or authorise the publication of a translation or if such translation is out of point. Reasonable compensation will have to be given to the owner for such translation (S. 32)

Performing Rights Societies

A performing rights society is *defined* as meaning a society, association or other body, whether incorporated or not, which carries on business in India of issuing or granting licences for the performance in India of any works in which copyright subsists. [S. 2(r)].

These societies have been formed to enable composers, authors, playwrights etc. to obtain their lawful remuneration through an organisation which could collect royalty, etc. for the performance of their works and be able to take the necessary steps to restrain unauthorised performances.

It is now *compulsory* for every performing rights society to prepare, publish and file with the Registrar of Copyrights, *statements* of all fees, charges or royalties which it proposes to collect for the grant of licences for performance in public of works in respect of which it has power to issue licences. If a society fails to do so in relation to any work, it will have to obtain the consent of the Registrar before taking any action or other proceeding to enforce any remedy, civil or criminal, infringement of the performing rights in that work (S. 33). Objections relating to published statements may be lodged in writing at the Copyright Office and will be referred to the Copyright Board for its decision (Ss. 34 & 35).

SUMMARY

TRADE MARKS

Law Applicable

Trade and Merchandise Marks Act, 1958.

What is a Trade Mark?

According to the definition of a trade mark under the Act, it may be made up of any device, heading, label, ticket, name, signature, word, letter or numeral.

What Trade Marks May be Registered

It must contain at least one of the following essentials:—

- (a) the name of a company individual, or firm, represented in a special or particular mannes;
- (b) the signature of the applicant for registration or some predecessor in his business;
- (c) one or more invented words;
- (d) one or more words having no direct reference to the character or quality of the goods, and not being according to its ordinary signification, a geographical name or a surname or a personal name or any common abbreviation thereof or the name of a sect, caste or tribe in India;
- (e) any other distinctive mark.

What Marks Cannot be Registered

- (1) The use of which would be likely to deceive or cause confusion;
- (2) the use of which would be contrary to any law for the time being in force;
- (3) which comprises or contains scandalous or obscene matter;
- (4) which comprises or contains any matter likely to hurt the religious susceptibilities of any class or section of the citizens of India;
- (5) which would otherwise be disentitled to protection in a court;
- (6) which is identical with or deceptively similar to a trade mark which is already registered in the name of a different proprietor in respect of the same goods or description of goods except where the Registrar is satisfied as to its honest concurrent use or in other special circumstances;
- (7) no word which is the commonly used and accepted name of any single chemical compound (as distinguished from a mixture) can be registered as a trade mark in respect of a chemical substance or preparation; or
- (8) which falsely suggests a connection with any living person or a person who died within 20 years before the date of application for registration Here the Registrar may require the application to furnish the consent in writing of such living person or of the legal representative of the deceased person before proceeding with the application.

Effect of Registration

- (1) Person registering gets an exclusive right to the use of the trade mark in relation to the goods mentioned in the registration.
- (2) Registration is *prima facie* evidence of its validity.

PATENTS

Law Applicable

The Patents Act, 1970

What is a Patent?

The grant by the Government of a monopoly in respect of an invention.

Term of Patent

The term for which a patent is granted is sixteen years from its date [S. 14].

Effect of Patent

Patentee gets exclusive privilege of making, selling and using the invention or method or process of manufacturing article by himself, his agent or licensees.

DESIGNS

Law Applicable

Designs Act, 1911

Definition

“Design” means only the nature of shape, configuration, pattern or ornament applied to any article by any industrial process or means, whether manual, mechanical, or chemical, separate or combined, which in the finished article appeal to and are judged solely by the eye; but does not include any mode or principle of construction or anything which is in substance a mechanical device, and does not include any trade mark as defined in Section 478, or property mark as defined in Section 479 of the Indian Penal Code.

Registration

On application to the Controller of Patents and Designs.

Effect of Registration

The registered proprietor gets a copyright in the design for five years from the date of registration. This can be extended before the expiration of the period.

COPYRIGHTS**Law Applicable**

- (1) Copyright Act, 1957.
- (2) Copyright (International Organisation) Order, 1958

What is Copyright?

The exclusive right of doing certain acts in relation to the following four classes of work:—

- (1) Literary, dramatic or musical work.
- (2) Artistic work.
- (3) Cinematograph Film.
- (4) Record.

Term of Copyright

- (1) In literary, dramatic, musical or artistic work—until 50 years from the beginning of the calendar year next following the year in which the author dies or in the case of joint authors, the joint author who dies last.
- (2) In anonymous or pseudonymous work—until 50 years from the beginning of the calendar year next following the year in which the work is first published. If, however, the author's identity is revealed before expiry of that period then until 50 years from the beginning of the next calendar year following the year in which the author dies.
- (3) In posthumous work—until 50 years from the beginning of the calendar year next following the year in which the work is first published.
- (4) In photographs and cinematograph film, Government work and work of International Organisations—until 50 years from its publication and not from date when it is taken.

TYPICAL QUESTIONS

1. What is a Trade Mark? What information need be supplied for registration of a Trade Mark?
2. What is the effect of registration of a Trade Mark?
3. Can Trade Marks be assigned? Describe the procedure of assignment of registered Trade Marks and state whether unregistered Trade Marks can be assigned.
4. What is a Patent? Who can apply for, and oppose grant of, a Patent?
5. When does a Patent expire? Can the time be extended? If so, how and in what circumstances?
6. A shopkeeper sells goods which are in fact an infringement of a patent. He is subsequently sued by the owner of the patent who claims an injunction and damages. The shopkeeper pleads ignorance of the existence of the patent. Can the owner of the patent succeed?
7. Define "Copyright". Can it be assigned? If so, during what period and by whom?

Part 3

INDUSTRIAL LAW

^I _N INTRODUCTION INTRODUCTION

INDUSTRIAL LAW consists of statute law and common law as developed by decisions of courts. There is a blending of Law and social justice in the matter of administration of labour legislation. This is natural since the objective of industrial legislation is to protect the weaker sections of society and to ensure that they work in comfortable conditions and for reasonable remuneration.

Labour welfare is a subject which is in the concurrent list of the Constitution. Hence both the state and central governments are entitled to legislate on the subject. Central enactments have applicability all over India. A state enactment covers only the particular state. There may be rules framed by a state government in respect of a central Act for example, The Factories Act, 1948. Some subjects, such as festival holidays, come exclusively under the purview of state governments for the purposes of making laws. This part of the book dealing with Industrial Law covers broadly the more important central labour enactments and their applicability to the establishments coming under their purview. Natural justice has a say in the matter of interpretation of labour legislation.

There has been a tremendous growth of activity in the industrial sphere after India became a free nation. This increase in activity brought with it problems which the existing rules and regulations

could not satisfactorily administer and control. The idea of social justice too was gaining ground and started influencing labour capital relationship in a more pronounced way than before. It is in this context that the Industrial Disputes Act, 1947 was passed providing for settlement of industrial disputes by negotiation, conciliation and adjudication which came as a blessing to the working class. It is true that the state by this statute restricted the rights of an employer to have his own terms of employment with an employee. This is unavoidable in a transformation of this nature by which social justice was gaining momentum as a concept in industrial relations. In fact Article 43 of the Constitution is just but a recognition of this changeover. It runs, "The state shall endeavour to secure by suitable legislation or economic organization or in any other way to all workers, agricultural, industrial or otherwise, work, a living wage, conditions of work ensuring a decent standard of life and full enjoyment of leisure and social and cultural opportunities and in particular the state shall endeavour to promote cottage industries on an individual or co-operative basis in rural areas".

This idea of social justice underlying Article 43 of the Constitution did influence to an extent the decisions of courts and tribunals of the land. Social Justice being a vague and abstract principle varying from individual to individual, there was a divergence of views in the awards and judgements given or delivered based on this concept by the tribunals and courts in this country. They felt it difficult to apply the idea without any precise rules because such rules were incapable of formulation. The then Chief Justice of Bombay, Mr. M. C. Chagla, in *Prakash Cotton Mills Private Limited vs. State of Bombay* [1957 (2) LLJ 490] observed, "We must not forget that we are no longer living in the age of laissez faire and the relationship between the employer and employee are no longer solely governed by the principles of contract, contractual rights and liabilities but are now subject to principles of industrial law and also principles of natural justice. In our opinion, no labour legislation, no social legislation and no economic legislation can be considered by a court without applying the principles of social justice in interpreting the provisions of these laws. Social justice is an objective which is embodied and enshrined in our constitution. It is true that it may be difficult to define social justice. In the opinion of Mr. Justice Holmes, it is an inarticulate major premise which is personal and individual to every court and every judge. How a court or a Judge approaches a particular problem is influenced and coloured by his outlook on life and society. But, however a

court or judge may approach a particular problem, it cannot ignore the fact that all our legislation is aimed at bringing about social justice and therefore it would indeed be startling for anyone to suggest that the court should shut its eyes to social justice and consider and interpret the law as if our country had not pledged itself to bringing about social justice. Therefore it is a truism to say that the present tendency of our labour and industrial legislation is to impose more and more burdens upon the employers. These burdens are imposed in the interests of employees because they have been underdogs for decades and centuries and the legislature wants to raise their status and therefore an employer cannot be heard to say: There is an unreasonable restriction upon my right to carry on business or hold or possess property because the burden inflicted upon me by law is such as in my opinion is intolerable. In the larger interests of the country an employer must submit to those burdens and carry on business in conformity with social legislation which is put on the statute book.

But it is necessary here to note the limitations of this concept of social justice as pointed out by Mr. Justice Balakrishna Aiyar of the Madras High Court when he said: "concepts of social justice have varied with age and claim. What would have appeared to be indubitable social justice to a Norman or Saxon in the days of William the conqueror will not be recognized as such in England today. What may appear to be incontrovertible social justice to a resident of Quebec may wear a different aspect to a resident of Peking. If it could be possible for Confucius, Manu, Hammurabi and Solomon to meet together at a conference table, I doubt whether they would be able to evolve agreed formulas as to what constitutes social justice. No definition exists of concepts of social justice which is a very controversial field. Courts and Tribunals created by the law must guide themselves by the directions and principles embodied in the law. If the law declares that a line or course of conduct is illegal, they must give effect to that declaration. In countries with democratic forms of government public opinion and law act and react on each other. Sometimes the law sets the pace and public opinion catches up with the law. In other cases where the law lags behind public opinion, the presence of public opinions brings about a change in the law. But so far as courts and tribunals are concerned the important thing is that they are bound by the law as it stands and must give effect to it. They cannot ignore the law by appeals to undefined and contentious concepts". The Management of *Sridharan Motor Service v. Industrial Tribunal and others* 1961 (1) MLJ. 21.

Chapter 27

THE FACTORIES ACT, 1948

History

IN A REPORT made in 1872-73 on the Administration of the Bombay Cotton Department, Major Moore drew the attention of the Government to the abuses of child and woman labour. It appears that children of six years of age were employed in factories and were made to work from sunrise to sunset with a brief interval of half an hour for meals.

In 1872-73 there were 18 cotton mills in Bombay employing about 10,000 workers. The rapid growth of the cotton mill industry in Bombay alarmed the Lancashire Manufacturers. They agitated for the regulation of labour conditions in India, in which they were supported by philanthropists both in England and in India. This led to the appointment, by the Government of Bombay, of a Commission in 1875. The majority of the members of the Commission were not in favour of any regulation. The agitation in the Press and Parliament, however, resulted in the enactment of the Indian Factories Act in 1881. This was the first comprehensive Act which regulated labour in the factories. There were subsequent Act and the law regulating labour was consolidated by the Factories Act, 1934. There were subsequent amendments to this Act also, which was finally repealed by the Factories Act, 1948. This Act came into

force on April 1, 1949 and is still in force as amended from time to time. This Act recognises the principle that a factory worker should be assured of his health, safety and welfare and attempts to secure for him his elementary rights and basic comforts.

Object

The object of the Factories Act is to protect the position of workmen of various ages employed in factories by laying down rules relating to their health and safety, conditions of employment, etc. The Factories Act, 1948, extends the scope of factory legislation to manufacturing establishments where ten or more workers are employed if power is used and in other cases where twenty or more workers are employed. This Act makes provisions for maintenance of the *health* of the worker (through cleanliness, adequate ventilation, lighting, prevention of dust and fume, etc.) as well as for the workers' *safety* and *welfare*. Each of these three topics has been dealt with in a separate chapter in the Act. The important provisions are discussed and the important definitions as given in the Act are also mentioned below. In the case of new factories and in the case of extensions of existing factories, plans and specifications are to be submitted for approval to the State Government. This Act embodies the old international provision that a person should not employ a worker unless proper safeguards are provided for his *health, safety* and *welfare*.

Definitions

For the purpose of this Act, the word "factory" is defined as follows—

"Factory" means any premises including the precincts thereof—

- (i) whereon ten or more workers are working, or were working on any day of the preceding twelve months, and in any part of which a manufacturing process is being carried on with the aid of power, or is ordinarily so carried on, or
- (ii) whereon twenty or more workers, are working, or were working on any day of the preceding twelve months, and in any part of which a manufacturing process is being carried on without the aid of power, or is ordinarily so carried on—but does not include a mine subject to the operation of the Mine Act 1952¹ (35 of 1952) or a mobile unit belonging to the armed forces of the union or a railway running shed or a hotel, restaurant or eating place [S. 2 (m)]

In order to determine whether any establishment is a factory, it must be proved—

¹ XXXV of 1952

- (a) that a manufacturing process is carried on in any part of the premises of that establishment; and
- (b) that depending on whether the manufacturing process is being carried on with or without the aid of power, there are the prescribed number of workers as defined in the Act, employed on that part of the premises where the said manufacturing process is carried on. Further, the mere fact that power is used in the premises will not be determinative; the power used must be in aid of the manufacturing process²

The word *manufacturing process* as used in the above definition means —

“any process for—

- (i) making, altering, repairing, ornamenting, finishing, packing, oiling, washing, cleaning, breaking up, demolishing, or otherwise treating or adapting any article or substance with a view to its use, sale, transport, delivery, or disposal; or
- (ii) pumping oil, water or sewage; or
- (iii) generating, transforming or transmitting power; or
- (iv) composing types for printing, printing by letterpress, lithography, photo-gravure or other similar process or book-binding;
- (v) constructing, reconstructing, repairing, refitting, finishing or breaking up ships or vessels”. [S 2(k)]

It has been held that *bidi*-making, conversion of raw films into a finished product, the preparation of food-stuffs and other eatables in the kitchen of a restaurant, use of a refrigerator for treating or adopting any article with a view to its sale, are manufacturing processes

The word “*worker*” is defined by the Act as meaning—

“Worker” means a person employed, directly or by or through any agency (including a contractor) with or without the knowledge of the principal employer, whether for remuneration or not in any manufacturing process or in cleaning any part of the machinery or premises used for a manufacturing process or in any other kind of work incidental to or connected with the manufacturing process or the subject of the manufacturing process but does not include any member of the armed forces of the Union [S.2(1)].

“Worker” thus means —

- (1) any person in the employment of the factory, in any manufacturing process or process incidental thereto;
- (2) whether for wages or not; and
- (3) whether directly or through any agency.

² *New Taj Mohal Cafe Ltd., Mangalore v. Inspector of Factories, Mangalore* 1956 I, LL. J. 273.

The definition has been made wider by the Amending Act of 1976 to include even those employed through a contractor with or without the knowledge of the principal employer.

Thus a person falls within the definition of “worker” only when both the following conditions are satisfied, namely—

- (1) There is an employment in service of another; and
- (2) such employment is in a manufacturing process or incidental thereto.

The word “employment” includes three things in its concept—

- (a) A person who employs, that is, one who engages the service of another.
- (b) A person who is employed, that is, one who works for another under his control and supervision.
- (c) The contract employment or service between the two whereunder latter agrees to serve under his control and supervision.

In *Chintaman Rao v. State of M.P.*³ it was held that employees of a contractor, over whose work, the owner of factory has no direct control or supervision, are not “workers” within the meaning of S.2(L). and the manager of factory does not commit any offence if he does not comply with the provisions of Secs. 62 and 63 as to maintenance of the Register of Workers in respect of such persons.

Thus the test for determining whether persons working in a factory are “workers” within the meaning of S 2(1) or are independent contractors lies in the nature of the terms on which they work. If the owner of factory has the right not merely to direct what work is to be done but also to supervise and control the work and to direct the manner in which that work is to be done, the persons working in his factory are “workers” and they are entitled to all benefits given under the Act to workers.

Whether a person is a worker or not within the meaning of the Factories Act, by virtue of Section 70 of the Bombay Shops and Establishment Act, 1948, wherever the said Act has been made applicable, the protection of the Factories Act, 1948, has been extended to all persons working in the precincts of a factory to whom the said Act does not apply.

The words “occupier of a factory” mean—

The person who has ultimate control over the affairs of the factory, and where the said affairs are entrusted to a managing

³ AIR. 1958, S.C. 38

agent, such agent shall be deemed to be the occupier of the factory [S.2(n)].

These words with reference to the present Act in general mean a person who occupies the factory either by himself or his agent. He may be an owner, a lessee or a mere licensee, but he must have the right to occupy the property and dictate terms of management.⁴

In another case of *John Donald Macckenzie v Chief Inspector of Factories, Bihar*⁵ it was held that a manager of a factory can be recognised as its "occupier" under section 2 (n) only when proper evidence is produced to show that ultimate control over the factory has been transferred to him by the owners. Otherwise, authority under the Act is justified in referring to entertain an application made to it. Shareholders in a private company are not liable as occupiers under the Act.

Health

The Factories Act 1948 deals with the health of the workers under a separate chapter and makes provision for maintenance of cleanliness disposal of waste and effluents, adequate ventilation and temperature, *cleanliness* the Act lays down that every factory must be kept clean from effluvia arising from any drain, privy or other nuisances. It makes particular mention of the removal of accumulation of dirt and refuse which must be removed daily. The floor of every work-room must be cleaned at least once a week by washing and using disinfectants where necessary. If the floor is liable to become wet in the course of any manufacturing process, effective drainage should be provided and maintained. It also provides for regular repainting or revarnishing every 5 years of all inside walls and partitions, all ceilings and all walls, sides and tops of passages and staircases, where such walls are painted or varnished Other types of walls, etc., must be kept whitewashed or colourwashed which must be redone once in every 14 months. The date on which these processes are carried out must be entered in the prescribed register [S. 11].

Effective arrangements are required to be made in every factory for the *disposal of waste and effluents* caused by the manufacturing process. The State Government is empowered to make rules in this connection [S 12]

Effective and suitable provision must be made for adequate *ventilation*, by securing the circulation of fresh air and for maintaining

⁴ *Emperor v. J. N. Modi*, AIR 1931, Bom. 308

⁵ AIR, 1962 S, J

a proper *temperature* to secure to workers in the factory reasonable conditions of comfort and to prevent injury to health [S. 13] When in a factory, by reason of the manufacturing process carried on, *dust or fume* or other impurity likely to be injurious or offensive to the workers is given off, effective measures must be taken to prevent its inhalation and accumulation in any workroom [S. 14].

In case of factories where there is *artificial humidification*, i.e. the humidity of the air is artificially increased, the State Government may make rules prescribing standards of humidification regulating the methods used for creating such humidity, directing prescribed tests for determining the humidity and prescribing methods for securing adequate ventilation and cooling of the air in the workroom. The water used for this purpose must be taken from a public supply or other source of drinking water or must be effectively purified before it is so used. If it appears to an Inspector that the water used for increasing humidity does not appear to be effectively purified, he may serve on the manager of the factory an order in writing specifying the measures to be adopted before a specified date [S. 15]

Provision is also made by this Act to prevent *overcrowding* to an extent injurious to the health of the workers employed in the factory. Apart from this requirement, there must be in every workroom of a factory in existence at the date of the commencement of the Factories Act at least 350 cubic feet of space for every worker employed therein and at least 500 cubic feet in the case of other factories, no account being taken of any space which is more than 14 feet above floor level. The Chief Inspector may by order in writing require a notice to be posted in each workroom of a factory, specifying the number of workers who may be employed in the room. The Chief Inspector is also empowered to exempt conditionally or otherwise, any workroom from complying with the provisions of this section if he is satisfied that it is unnecessary in the interest of the health of the workers [S. 16].

Every part of the factory must be provided with sufficient and suitable *lighting* natural or artificial or both and effective provision must be made for prevention of glare and the formation of shadows likely to cause eye strain or the risk of accident to any worker. The State Government may prescribe standards of sufficient and suitable lighting for factories or for any manufacturing process [S. 17].

Factories must make adequate provision for maintaining wholesome *drinking water* at suitable points conveniently situated

for all workers. All such points must be legibly marked "drinking water" in a language understood by a majority of the workers employed in the factory and no such point should be situated within 20 feet of any washing place, urinal or latrine unless a shorter distance is provided in writing by the Chief Inspector. It is also provided that if more than 250 workers are ordinarily employed in a factory provision should be made for cooling drinking water during hot weather by effective means and for its distribution. The State Government is empowered to make rules for securing compliance with these provisions as well as for the examination by prescribed authorities of the supply and distribution of drinking water in factories (S. 18).

Sufficient arrangements must be made *for latrines and urinals* and separate enclosed accommodation has to be provided for female and male workers. This accommodation must be adequately lighted, ventilated and maintained in a clean and sanitary conditions. Sweepers must be employed whose primary duty would be to keep these places clean. The State Government may prescribe rules in respect of sanitation in factories as it considers necessary in the interest of the health of the workers (S. 19).

Sufficient number of *spittoons* must also be provided in convenient places and maintained in a clean and hygienic condition. No person is permitted to spit within the premises of a factory except in such spittoons as otherwise such person would be liable to pay a fine not exceeding five rupees (S. 20).

Safety

Production in any factory or other industrial establishment depends to a large extent on the attention that is paid by management to three factors namely: safety, health and welfare of the workers. Accidents are generally caused by machines, electricity and fire. Fencing of dangerous machinery and precautions to be observed by men who work near and at these machines are preventive measures which the Factories Act requires an employer to take in this regard. Women workers are not allowed to work on dangerous machines. Even for a young person to work on them there are restrictions in that he has to be sufficiently trained in that type of work and has to work under the supervision of an expert adult worker in that line. Tight clothes are to be worn by the workers whilst at work. The personal factor in respect of the worker should also receive the attention of the employer. He should not be

allowed to adopt unsafe practices in the course of work for any reason. His mental attitude towards the work should also be carefully watched. Workers who have bodily defects which make them unsuitable for a particular type of work should be transferred to other departments suitable to their nature. Even in respect of the skill and diligence required, there should be a constant check to ensure that these exist to the required extent in the worker. Maintenance of machines should also receive adequate attention from the management.

Electrical accidents usually occur due to non-provision of adequate guarding arrangements or protective devices. The workmen detailed to do electrical jobs should be properly trained on the hazard of electricity and must be provided with a standard set of tools for use. Only qualified men should be allowed to do the work. Provision must be there to cut off electricity in the event of an emergency developing whilst the men are at work on the lines. Electrical installations should at all times be checked and maintained in good condition and order.

Fire is caused by the presence of inflammable materials at a temperature conducive to ignition. There exists equipments which detect flames in the atmosphere of the establishment. Experience also will teach as to how to detect a forthcoming fire and prevent an accident. There is of course, a chance of a slip up, hence, the necessity to instal a sufficient number of fire extinguishers to extinguish a fire in the event one breaks out. Exit doors from rooms should not be locked or fastened so that in emergencies like fire, persons inside could go out quickly. Means of escape should be indicated in bold letters and sirens should be installed to warn the workers in the event of a fire breaking out.

Statistics of past accidents with a complete history behind them will also be of assistance in avoiding future accidents by indicating where the weak link in the chain lies. The selection of clothing material for the worker should ensure that there are no attachments to it like plastic materials which are inflammable. Safety measures and the need to observe them must be brought to the notice of the workers by means of posters, slides, films and similar publicity media. Safety competitions at the end of which rewards are offered to the best participants will also propagate the value of safety. An impression should be created in the minds of the workers on the value the management attaches to safety and safe practices. It should be pointed out to the worker that he should never

choose an unsafe method because it is easier for him. Safety measures pay dividends in the long run. Establishment of safety committees to promote safety by co-operation between employers and employees is another step in the right direction to ensure safety.

A separate chapter (Ss. 21-41) is also devoted in the Factories Act 1948, for provision regarding the safety of workers in factories. The following *machinery* is required by section 21 to be *securely fenced*—

(i) Every moving part of a prime mover and every fly wheel connected to a prime mover;

(ii) the headrace and tailrace of every waterwheel and water turbine;

(iii) any part of a stock bar which projects beyond the head stock of lathe; and

(iv) unless they are in such position or of such construction as to be safe to every person employed in the factory as they would be if they were securely fenced the following—

(a) every part of an electric generator, a motor or rotary convertor;

(b) every part of transmission machinery; and

(c) every dangerous part of any other machinery.

The Act provides that it should be *securely fenced* by safeguards of substantial construction so that the safety of the workmen employed in the factory and near the dangerous types of machinery is assured as far as possible. The *inspectors* have to see that this fencing is constantly maintained in an efficient state. It has been held in one case, viz, *Jackson v. A G. Mulliner Motor Body Co. Ltd.*⁶ that *this obligation for fencing is absolute* and applies to every hoist or teagle whether connected with mechanical power or not. It is not sufficient that this fencing is done in a manner usual in the best factories of the district, but it must be fenced according to the best method known at the time so as to be equally safe, whichever way the machinery is worked.⁷ In one other case the Court went further and laid down that it was necessary to fence even though it is commercially impracticable or mechanically impossible to fence securely.⁸ The trend of all the English decision clearly shows that the Courts have taken the requirements of the Act as to fencing very seriously and have persisted in emphasising that there should be no possible concession in this connection.

⁶ (1911), 1 K.B. 546

⁷ *Schofield v. Schunck* (1855), 24 Lt. (O.S.)

⁸ *Davis Thomas Ovan & Co. Ltd.* (1919), 2 K.B. 39

It has been held in a recent case that under Section 21 (1)(iv)(b) above the safety contemplated either by securely fencing the transmission machinery or by its position or by its construction is absolute safety but only against reasonably foreseeable risks and dangers of coming into contact with the transmission machinery. Carelessness, indolence, inadvertence, weariness and even disobedience of a workman were to be regarded as things which an occupier of a factory can and is expected to reasonably foresee and should, therefore provide against, but that there was no duty under Section 21(1) to provide against danger arising from the shifting or repairing or of installing new machinery.⁹

Provisions are also made regarding employing of young persons on dangerous machines, casing of new machinery, prevention of lifting of excessive weights, protection of the eyes, precaution in case of fire, precautions against dangerous fumes, and generally with regard to the safety of the employees in factories. The Act provides that in every factory *hoist and lift* must be made of good mechanical construction, sound material and adequate strength. It should be properly maintained and thoroughly examined by a competent person at least once in six months. Every hoistway and liftway must be sufficiently protected by a proper enclosure and the maximum safe working load must be plainly marked on every hoist or lift and a larger load should not be carried thereon. In case of *cranes and other lifting machinery* they should also be of good construction, sound material and adequate strength and should be properly maintained and examined by a competent person once at least in every 12 months. A *register* has to be maintained containing the prescribed particulars of every such examination. All floors, steps, stairs, passages and gangways must also be of sound construction and properly maintained and there must always be, as far as is reasonably practicable, *safe means of access* to every place at which any person is at any time required to work.

There must be suitable devices in every workroom for *cutting off power* from running machinery in *emergencies*.

No person should be employed in a factory to lift *excessive weights*, i.e., to lift, carry or move any load so heavy as to be likely to cause him injury. In case of any manufacturing process carried on in any factory involving *risk* of injury to the eyes from particles or fragments thrown off or by reason of exposure to excessive light the State Government is given the power to make rules requiring

⁹ *State v. L.C. Patel* (1959) 61 Bom. L.R. 1021

that such factories must provide effective screens or suitable goggles to protect the workers. Provisions are also made by the Act that all practicable measures must be taken to *prevent explosion* and also to provide *for means of escape in case of fire*. Every factory must provide an effective and clearly audible means of giving warning in case of fire to every person employed in the factory.

The State Government is also given the power to make rules to give effect to the safety provisions of the Act such as for provision of automatic guards, further fencing of particular machinery or of articles in motion in machines, stopping of machines in case of danger, etc.

In every factory wherein one thousand or more workers are ordinarily employed or wherein in the opinion of the State Government any manufacturing process or operation is carried on, which process or operation involves any risk of bodily injury, poisoning or disease or any other hazard to health, to the persons employed in the factory, the occupier shall if so required by the State Government by notification employ such number of safety officers as may be specified in the notification.

Health and Welfare

There are two aspects to the problem of industrial health. The first is to maintain the health of the existing employees who are normal. The second is to prevent the worker enjoying such normal health from being affected by disease. Medical examinations complete in all respects is a must for all new entrants to the establishment. Even whilst fixing them on jobs, care should be taken to ensure that they are suitable for the job. If the unsuitability comes to the notice of management only subsequent to the date of employment, the concerned worker should be eliminated from the job and provided with alternate work. Workers suffering from contagious disease should be separated from the others. The more serious problem is occupational disease. The environmental factors which cause these diseases should be studied at length and ways and means found to avoid or at least reduce their incidence to the minimum. Periodical medical examination of the employees and immunizing them when epidemics break out, will go a long way to preserve industrial health.

Industrial welfare means the looking after of the employee by the employer by providing him with facilities ordinarily required to

make a worker contented and happy in body and spirit. The facilities extended should not only cover his period of work at the establishment but also his life outside. The working atmosphere should be congenial in the sense that it should be well ventilated, lighted and comfortable. Such surroundings give a sense of pleasure to the employee at work. The next important aspect is provision of good subsidised food and refreshments to the workers through the canteens. Good working atmosphere and food will make the worker put in his maximum effort at the job which the employer has provided for him.

Medical facilities are also important. There is no problem in this regard for employers whose employees are covered under Employees' State Insurance. The Corporation provides them with the required medical attention. For other employers it would be necessary to extend the required facilities to their employees. The incidence of sickness results in absenteeism of employees which in turn affects production. Hence the medical facilities extended should not only cover during of sickness but also prevention of workers falling ill. Such facilities should also be made applicable to the families of the workers.

Housing schemes for workers come next. A house of his own to live in gives a sense of security and satisfaction to the worker. If this is not possible, the employer may at least provide the worker with quarters for stay during the period of his service. Industrial colonies satisfy these needs to an extent. But the problem of housing the industrial worker does not appear to have made much progress in spite of the subsidies and assistance the governments are willing to extend in this connection. Probably the employers feel the task to be too big for them. The Housing Boards and the co-operatives are to an extent filling up the gap created by the reluctant employers in this direction.

Recreational facilities come next. A worker who works for an employer for long hours needs some relaxation and entertainment to make him fit for work the next day. A club room with provision for indoor games and reading materials will be an ideal industrial welfare measure. A playground with facilities for outdoor games will also be good. Organising a film show once in a way and installation of a radio set at the club premises are welcome additions.

Facilities for education of the children of the worker and extension of credit facilities for him to purchase articles of essential nature through co-operatives are some other measures which an

employer could think of extending to his employees. The list is not exhaustive by any means but only illustrative. There are several other welfare measures which an employer could think of extending to his workers to make them healthy in body and spirit.

A separate chapter [Ss. 42-50] is provided with regard to the welfare of workers in factories. Every factory must provide and maintain adequate and suitable facility for *washing* which should be adequately screened for the use of male and female worker. This facility should be conveniently accessible and kept clean. Facilities must also be provided for the *storage of clothing* not worn during working hours and the *drying of wet clothing*. Where workers are obliged to work in a standing position suitable arrangements for *sitting* should be made so that such workers may take advantage of an opportunity for rest which may occur in the course of their work. Providing of *first-aid appliances* are made obligatory by the Act. Every factory must have first-aid boxes or cupboards equipped with the prescribed contents so as to be readily accessible during working hours. In case of factories employing more than 500 workers, they must maintain an ambulance room in charge of properly qualified medical and nursing staff. In case of factories employing over 230 workers, the State Government is given the right to require such factories to maintain a *canteen*. Where more than 150 workers are employed adequate and *suitable shelters or rest rooms* and a suitable *lunch room* should be provided and maintained. Where such a lunch room exists no workman is permitted to eat any food in the work-room. *Creches* must be maintained for children under six of women workers in every factory in which more than 30 women are ordinarily employed. Such rooms must have adequate accommodation, be well lighted and ventilated, maintained in a clean and sanitary condition and under the charge of women trained in the care of children and infants. Suitable provision must be made in such creches for washing and changing the clothing of the children and for the supply of free milk or refreshment or both. Facility must also be given to mothers to feed their children at necessary intervals. In the case of factories employing 500 or more workers a prescribed number of *Welfare Officers* must be employed. The State Government is given the right to prescribe the duties, qualifications, and conditions of service of such officers.

Women, Children and Adolescents

The Factories Act makes numerous provisions for the protection of women, children and adolescents. A *child* is defined by the Act

as "a person who has not completed his fifteenth year of age". An *adolescent* means "a person who has completed his fifteenth year of age but not completed his eighteenth year". A *young person* means "a person who is either a child or an adolescent". An *adult* means "a person who has completed his eighteenth year of age". The Act prohibits a woman or child being permitted to clean, lubricate or adjust any part of the machinery while that part is in motion, or to work between moving parts, or between fixed and moving parts, of any machinery which is in motion. Young persons are prohibited from working at any machine which in the opinion of the State Government is of such a dangerous character that a young person ought not to work at that unless he has received sufficient training in working at the machine or is working under adequate supervision of a person who has a thorough knowledge and experience of such machine [S. 23].

Women and children are also prohibited from being employed in any part of a factory for pressing cotton in which a cotton opener is at work, provided that if the feed-end of a cotton opener is in a room separate from the delivery and by a partition extending to the roof or such height as the Inspector may in any particular case specify in writing, women and children may be employed on the side of the partition where the feed-end is situated [S. 27].

In the case of *women*, no woman can be employed in any factory before six o'clock in the morning or after seven o'clock in the evening and in the aggregate for more than nine hours in any one day. Here also an interval of at least one hour ought to be provided for and no female employee can be employed at one time at a stretch for more than six hours. The State Government cannot extend the limit of 9 hours neither can it authorise employment of any women between 10 p.m. and 5 a.m. and there cannot be change of shifts except after a weekly holiday or any other holiday.

A *child* who has not completed his fourteenth year is prohibited by section 67 from working in any factory.

A *child* who has completed his fourteenth year can work in a factory provided a certificate to work in a factory as a child has been granted by a certifying surgeon after examination.

In the case of an *adolescent* the certificate required is of fitness to work as an adult. Such certificates can only be granted or renewed if the certifying surgeon has personal knowledge of the place where the young person proposes to work or he has examined such a place.

While working such child or adolescent is required to carry a token giving reference to such certificate (S. 68).

A certificate of fitness will be valid for twelve months, may be issued subject to conditions or may be revoked. If a certificate or its renewal is refused reasons in writing must be stated. The fee for such a certificate is to be paid by the occupier of the factory and is not to be recovered from the young person.

An adolescent who is granted a certificate to work as an adult will be deemed to be an adult but if he has not attained the age of seventeen he cannot work in a factory during night. Here *night* will mean a period of at least 12 consecutive hours including an interval of at least seven consecutive hours falling between 10 p.m. to 7 a.m. An adolescent who is not granted such a certificate will be deemed to be a child.

Children cannot work in any factory—

- (1) For more than four and a half hours in any day;
- (2) during the *night i.e.* period of at least 12 consecutive hours including the interval between 10 p.m. and 6 a.m.;
- (3) on any day on which he has already been working in another factory; and
- (4) for more than 2 shifts. Such 2 shifts must not overlap or spreadover more than 5 hours each, and each child must be employed in only one of the relays which must not be changed more frequently than once in thirty days except with the previous permission in writing of the Chief Inspector.

The provision of section 52 as to *weekly holidays* for adults will also apply to child workers and no *exemption* can be granted from this provision.

A notice of the periods of work per day for children should be displayed and correctly maintained in every factory as provided by section 72.

A Register of child workers must be kept by the manager of every factory and be available to the Inspector during working hours or when any work is being carried on in the factory. The Register must show the following—

- (a) The name of the child worker in the factory;
- (b) the nature of his work;
- (c) the group, if any, in which he is included;

- (d) where his group works on shifts, the relay to which he is allotted; and
- (e) the number of his certificate of fitness.

The Inspector is empowered by section 75 to require the medical examination of any person working in a factory without a certificate of fitness if the inspector is of opinion that such person is a young person or that a young person who has a certificate of fitness is no longer fit to work in the capacity stated therein.

These provisions in the Factories Act relating to children are in addition to the provisions of the Employment of Children Act, 1938.

Working Hours of Adults

Generally speaking, for all employees the provision is that no adult worker shall be employed in a factory for more than *forty-eight hours in any week* or more than *nine hours in any one day*. The other rule is that no adult worker is to be employed on the first day of the week unless he has had or is going to have a holiday for a whole day on one of three days immediately preceding or succeeding the said day and the manager has, previous to the said day or substituted day whichever is earlier, given notice of his intention to do so to the Inspector and displayed a notice to that effect in the factory. The substitution should not result in the worker working for more than 10 days continuously with a holiday for a whole day. The period of work should be so fixed that no worker is required to work for a period exceeding 5 hours without a *rest interval* of at least half an hour. The periods of work including such intervals for rest should not *spread over* more than $10\frac{1}{2}$ hours in any day. Any worker required to work in the factory for more than 9 hours in any day or for more than 48 hours in any week must be paid *extra wages for overtime* at the rate of twice the ordinary rate of wages. Every factory must display *notices* of periods of work for adults and for children showing clearly for every day the period during which such worker would be required to work.

Registers of adult workers and child workers must be maintained by the manager of every factory. These registers should be available to the Inspector at all times during working hours. or when work is being carried on in the factory and must show the names of each worker, the nature of his work, the group, if any, in which he is included, the relay to which he is allotted where his group works on shifts and other prescribed particulars. It may be

mentioned that the Act defines "*day*" as meaning a period of 24 hours beginning at midnight, "*week*" has been defined as meaning a period of 7 days beginning at midnight on Saturday night or such other night as may be approved in writing for a particular area by the Chief Inspector of Factories.

The rule with regard to these hours have been very strictly construed in English law courts where in one case,¹⁰ a boy who cleaned machinery for his own amusement during meal times was held to be working. Further it is provided that no person shall be allowed to work in any factory on any day on which he has already been working in any other factory. The State Government has been given power to make exempting rules in connection with workers engaged on urgent repairs or engaged in any work which for technical reasons must be carried on continuously throughout the day or engaged in making or supplying articles of prime necessity. Such an exempting rule can also be made where the work is such that it must necessarily be carried on outside the limits laid down for the general working for the factory. In making such rules the total number of hours of work in any day should not however exceed 10 and the total number of hours of overtime work should not exceed 50 for any one quarter. "*Quarter*" means a period of three consecutive months beginning on January 1, April 1, July 1, or October 1. The spreadover should not exceed 12 hours in any one day.

Inspectors

Inspectors are officers appointed by the State Government by notification in the Official Gazette to act in such capacity. The inspecting staff under the Factories Act consists of the Chief Inspector, Inspectors and Additional Inspectors [S.8]. These Inspectors are persons who are not directly or indirectly interested in a factory or in any process or business carried on therein or in any patent or machinery connected therewith. These inspectors have powers subject to the rules in that behalf which they can exercise within the local limits for which they are appointed—

(a) to enter, with such assistants being persons in the service of the Government, or any local or other public authority, as they think fit, any place which is, or which they have reason to believe is used as a factory;

(b) to make examination of the premises, plant and machinery, require the production of any prescribed register and any other

¹⁰ *Prior v. Staithwaite Spinning Co.* (1898), 1 Q. B. 881.

document relating to the factory, and take on the spot or otherwise statements of any persons which they may consider necessary for carrying out the purposes of this Act; and

(c) to exercise such other powers as may be necessary for carrying out the purposes of this Act.

Provided that no one shall be required under this section to answer any question or give any evidence tending to criminate himself [S.9].

It should be noted that the *responsibility* to comply with the *safety provisions* of the Factories Act *lies with the occupier*. Formerly Inspectors visited factories to point out dangerous machinery which required fencing and instructed the occupier as to what safety measures he should take. This resulted in occupiers neglecting safety measures until an Inspector came round. Now the occupier must comply with the provisions of the Act without waiting for an Inspector to give instructions as to what steps he should take.

Welfare Officers

The occupier of every factory with 500 or more workers is obliged under S.49 of the Factories Act, 1948 to employ the prescribed number of Welfare Officers. The State Government is authorised to prescribe the duties, qualifications and conditions of service of such officers.

Where it is proposed to discharge or dismiss a Welfare Officer, Additional Welfare Officer or Assistant Welfare Officer, the employer must place before the Commissioner of Labour, prior to taking such action, the nature of the proposed action and the grounds thereof. The Commissioner is empowered to advise the employer on the proposed action after making such enquiry as he deems fit.

In *Pratab Chandra Sen v. Commissioner of Labour, Bihar* it was held that a Personnel Officer, who has not been appointed as a Welfare Officer in the factory cannot claim benefit of rules made under the Act by the State Government solely for Welfare Officers, and for terminating his service, the owner is not required to employ with procedure prescribed in these Rules.

Certifying Surgeons

These are qualified medical officers, appointed by the State Government, whose duty is to examine and issue certificates to young persons desirous of being employed in a factory situated

within the limits for which they are appointed, on the application of parents or guardians of such persons or of the manager of such factory in which such persons desire to be employed after examination. These surgeons have full power to revoke any certificate granted by them to any child who in their opinion is no longer fit for employment in a factory. Where such certificate is refused the certifying surgeon is required to state in writing his reason, for such refusal. The certifying surgeon with the approval of the State Government, has the right to authorize any qualified medical practitioner to exercise any of his powers under the Act. The duties of these certifying surgeons relate to the examination and certification of young persons under Factories Act; the examination of persons engaged in factories in the dangerous occupations or processes and exercise of medical supervision as may be prescribed for any factory [S.10].

Penalties and Procedures

General Penalties for Offences

If in or in respect of any factory there is any violation of the provisions of the Act or Rules or any order in writing given thereunder, same as otherwise expressly provided in the Act and subject to provisions regarding liability of owner of premises in certain circumstances (S.93), the occupier and manager of the factory shall each be guilty of an offence and shall be punishable with imprisonment extending to three months or with fine to Rs 2,000 or with both. The contravention, if continued, is punishable with a fine which may extend to Rs 75 for each day on which the contravention is so continued (S. 92).

Liability of Owners of Premises in Certain Circumstances

The owner of any premises, in which separate buildings are leased to different occupiers for use as separate factories, shall be responsible under section 93 (1) of the Act for the provisions and maintenance of common facilities and services, such as approach roads, drainage, water supply, lighting and sanitation. Subject to the control of the State Government, the Chief Inspector shall have the power to issue orders to the owner of the premises in respect of carrying out such obligations.

Sub section (3) of S. 93 provides that where in any premises independent or self-acquired floors or flats are leased to different occupiers for use as separate factories, the owner of the premises

shall be liable as if he were the occupier or manager of a factory, for any violation of the provisions of the Act.

Such owner shall also be liable under section 93 (5) where in any premises independent rooms with common latrines, urinals and washing facilities are leased to different occupiers for use as separate factories.

Exemption of Occupier or Manager from Liability in certain Cases

The employer and the manager are responsible for complying with the provisions of Act. If either of them is charged with an offence punishable under the Act he can have any other person whom he charges as the actual offender brought before the Court at the time appointed for having the charge, after duly complaining and giving to the prosecutor at least three clear day's notice in writing of his intention to do so. If after the commission of the offence is proved the occupier or manager, as the case may be, satisfy the Court that (a) he has used all due diligence to enforce the execution of the Act, and (b) that the said other person committed the offence in question without his knowledge, consent or connivance, the other person shall be convicted of the offence and shall be liable to the punishment, as if he was the occupier or manager of the factory. Then the occupier or manager shall be discharged from any liability in respect of such offence. However, in seeking to prove the non-commission of the offence by him, the occupier or manager, as the case may be, examined on oath and his evidence, and that of any witness in his support shall be subject to cross examination on behalf of the person charged by him as the actual offender and by the prosecutors. Further, if the person charged as the actual offender cannot be brought before the Court and the time appointed for hearing the charge, the Court shall adjourn the hearing from time to time for a period not exceeding three months and if by the end of this period, the said person cannot be brought before the Court, the Court shall proceed to hear charge against the occupier or manager. And, if the offence is proved, the occupier or manager shall be convicted (S. 101).

Obligations of Workers

No worker in a factory shall wilfully—

(a) interfere with or misuse or neglect to use any appliance, convenience or other thing provided in the factory for securing the health, safety or welfare of the workers therein; and

(b) without reasonable cause do anything likely to endanger himself or others.

A worker employed in a factory who violates any of the above provisions in Section III (1) or any Rules or order made thereunder shall be punishable with imprisonment extending to three months or with fine up to Rs 100 or with both.

Liability of Prosecutions

No Court shall take cognizance of any offence under the Act, unless complaint thereof is made within three months of the date on which the alleged offence came to the knowledge of an Inspector. However, where the offence consists of disobeying a written order of an Inspector, complaint thereof may be made within six months of the date on which the offence is alleged to have been committed.

QUESTIONS

1. Briefly state the provisions of the Factories Act with regard to the employment of women and children.
2. State briefly the steps to be taken by the occupier for the safety, health and welfare of factory workers.
3. Summarise the provisions of the Factories Act, 1948, for the welfare of the factory workers.
4. (a) Who are Certifying Surgeons? State the duties of Certifying Surgeons.
(b) State the powers of the Inspector of Factories to require medical examination of young persons amongst the workers in the factory.
5. State the provisions of the Factories Act regarding welfare and leave with wages.
6. Explain the principles of Industrial Safety, Health, and Welfare.

THE CONTRACT LABOUR (REGULATION AND ABOLITION) ACT, 1970

PRIOR TO THE enactment of this Act, there was a consistent demand by the labour for abolishing the system of contract labour, which gave rise to certain industrial adjudications. The question of ten raised was whether the directions given by the Industrial Tribunal abolishing the contract system was justified. The Supreme Court in *The Standard Vacuum Refining Company of India Ltd. v. Its Workmen and others*¹ laid down the principles that "if the work for which contract labour is employed is incidental to and closely connected with the main activity of the industry and is of a perennial and permanent nature, the abolition of contract labour would be justified. It is also open to the Industrial Tribunal to have regard to the practice obtaining in other industries in or about the same area". It may be pointed out here that most of the principles laid down by the Supreme Court have been given due regard in the Central Act.

The Act, as its preamble shows, was to regulate the employment of contract labour in certain establishments and to provide for the abolition in certain circumstances and for matters connected there-

¹ 1960, II L.L.J., 233

with. It received the assent of the President on September 5, 1970, and came into force on February 10, 1971. Under sub-section (4) of S. 1, the Act applies to every establishment as well as to every contractor who employs twenty or more workmen.

Definition

S. 2 defines the various expressions.

“Appropriate Government” means—

(1) In relation to—

(i) any establishment pertaining to any industry carried on by or under the authority of the Central Government, or pertaining to any such controlled industry as may be specified in this behalf by the Central Government; or

(ii) any establishment of any railway, cantonment board, major port, mine or oil field; or

(iii) any establishment of a banking or insurance company, the Central Government;

(2) In relation to any other establishment, the Government of the State in which that other establishment is situated [S. 2(9)].

“Contract Labour” A workman shall be deemed to be employed as “contract labour” in or in connection with the work of an establishment when he is hired in or in connection with such work by or through a contractor, with or without the knowledge of the principal employer [S. 2(b)].

“Contractor” in relation to an establishment, means a person who undertakes to produce a given result for the establishment, other than a mere supply of goods or articles of manufacture to such establishment, through contract labour or who supplies contract labour for any work of the establishment, and include a sub-contractor [S. 2(c)].

“Establishment” means—

(i) any office or department of the Government or a local authority; or

(ii) any place where any industry, trade, business, manufacture or occupation is carried on [S. 2(e)].

“Principal employer” means—

(i) in relation to any office or department of the Government or a local authority, the head of that office or department or such other officer as the Government or the local authority, as the case may be, may specify in this behalf;

(ii) in a factory, the owner or occupier of the factory and where a person has been named as the manager of the factory under the Factories Act, 1948, the person so named;

(iii) in a mine, the owner or agent of the mine and where a person has been named as the manager of the mine, the person so named;

(iv) in any other establishment, any person responsible for the supervision and control of the establishment.

Explanation: For the purpose of sub-clause (iii) of this clause, the expressions "mine", "owner" and "agent" shall have the meanings respectively assigned to them in clause (j), clause (l) and clause (e) of the sub-section (1) of Section 2 of the Mines Act, 1952 [S. 2(g)].

"Workman" means any person employed in or in connection with the work of any establishment to do any skilled, semi-skilled or unskilled, manual, supervisory, technical or clerical work for hire or reward, whether the terms of employment be expressed or implied, but does not include any such person—

- (A) who is employed mainly in a managerial or administrative capacity; or
- (B) Who, being employed in a supervisory capacity draws wages exceeding five hundred rupees per mensem or exercises, either by the nature of the duties attached to the office or by reasons of the powers vested in him, functions mainly of a managerial nature; or
- (C) who is an out-worker, that is to say, a person to whom any articles or materials are given out by or on behalf of the principal employer to be made up, cleaned, washed, altered, ornamented, finished, repaired, adapted or otherwise processed for sale for the purposes of the trade or business of the principal employer and the process is to be carried out either in the home of the out-worker or in some other premises, not being premises under the control and management of the principal employer [S. 2(c)].

Advisory Boards

Section 3 (1) provides for the Central Government constituting the Central Advisory Contract Labour Board, to advise the Central Government with regard to matters arising out of the administration of the Act.

Sub-section (2) provides for the composition of the said Board consisting of—

- (a) a chairman to be appointed by the Central Government;
- (b) the Chief Labour Commissioner (Central), ex-officio;
- (c) such number of members, not exceeding seventeen but not less than eleven, consisting of the representatives of the contractor, workmen and the industries concerned.

Under the proviso to sub-section (3), the number of members nominated to represent the workmen shall not be less than the number of members nominated to represent the principal employers and the contractors.

Section 4 deals with the constitution of a similar Advisory Board by the State Government. The said State-Advisory Board is also to include, among other persons, the representatives of the industry, the contractor and the workmen. A proviso to sub-section (3) of S. 4 similar to the proviso to sub-section (3) of S. 3 has also been enacted.

Registration of Establishments Employing Contract Labour

Section 6 deals with the appointment of registering officers by the appropriate Government by notification in the official Gazette. Section 7 makes it compulsory on the part of every principal employer of an establishment to which the Act applies to make an application to the registering officer within the time prescribed for registering of the establishment. Section 8 deals with revocation of registration in certain circumstances. Section 9 dealing with the effect of non-registration prohibits the principal employer of an establishment to which the Act applies from employing contract labour, if the establishment has not been registered under S. 7 within the time prescribed or in the case of an establishment in respect of which registration has been revoked under S. 8. Section 10 which prohibits the employment of contract labour is an important provision and is as follows—

- (1) Notwithstanding anything contained in this Act, the appropriate Government may, after consultation with the Central Board or, as the case may be, a State Board, prohibit, by notification in the official Gazette, employment of contract labour in any process, operation or other work in any establishment.
- (2) Before issuing any notification under sub-section (1) in relation to an establishment, the appropriate Government

shall have regard to the conditions of work and benefits provided for the contract labour in that establishment and other relevant factors, such as—

- (a) whether the process, operation or other work is incidental to or necessary for the industry, trade, business manufacture or occupation that is carried on in the establishment;
- (b) whether it is of perennial nature, that is to say, it is of sufficient duration having regard to the nature of industry, trade, business manufacture or occupation carried on in that establishment;
- (c) whether it is done ordinarily through regular workmen in that establishment or an establishment similar thereto;
- (d) whether it is sufficient to employ a considerable number of wholetime workmen.

Explanation: If a question arises whether any process or operation or other work is of perennial nature, the decision of the appropriate Government thereon shall be final.

The following points emerge from S. 10—

- (1) The appropriate Government has power to prohibit the employment of contract labour in any process, operation or other work in any establishment.
- (2) Before issuing a notification prohibiting contract labour, the appropriate Government has to consult the Central or State Board as the case may be, which comprises of the representatives of workmen, contractor and the industry.
- (3) Before issuing any notification under sub-section (1) prohibiting the employment of contract labour, the appropriate Government is found to have regard not only to the conditions of work and benefits provided for the contract labour in particular establishment, but also other relevant factors enumerated in cls. (a) to (d) of sub-section (2).
- (4) Under the explanation which really relates to cl. (b) the decision of the appropriate Government, on the question whether any process, operation or other work is of perennial nature, shall be final.

In the case of *Vegoils Private Ltd. v. Their workmen*² the question arose before the Supreme Court, as to what is effect of the Central and the State Acts regarding the jurisdiction of the Industrial Trib-

² 1971, II L. L. J. p. 587.

unal to entertain and adjudicate upon a dispute regarding abolition of contract labour. It was held that "the jurisdiction to decide about the abolition of contract labour or to put it differently, to prohibit the employment of contract labour is now to be done in accordance with S. 10. Therefore it is proper that the question whether the contract labour regarding loading and unloading in the industry of the appellant is to be abolished or not, is left to be dealt with by the appropriate Government under the Act if it become necessary".

Licensing of Contractors

Section 11 deals with the appointment of licensing officers by the appropriate Government for the purpose of Chapter IV. Sub-Section (1) of S. 12 prohibits a contractor to whom the Act applies, from undertaking or executing any work through contract labour except under and in accordance with the licences issued in that behalf by the licensing officers. Sub-Section (2) of S. 12 provides for a licence issued to a contractor containing conditions relating to hours of work, fixation of wages and other essential amenities in respect of contract labour which the appropriate Government may deem fit to impose by the rules made under S. 35. Sections 13, 14 and 15 relate to the procedure for the grant of licences, revocation, suspension and amendment of licences and appeals by persons aggrieved by the orders made under Ss. 7, 8, 12 and 14.

Welfare and Health of Contract Labour

Chapter V deals with the welfare and health of contract Labour. There are provisions made for the establishment of canteens and rest houses and to provide other facilities to the contract labour by the contractor.

Section 20 casts a liability on the principal employer to provide the amenities referred to under Ss. 16, 17, 18 and 19 for the benefit of contract labour employed in his establishment, if the contractor fails to provide those amenities. That section also enables the principal employer, if it provides those amenities, to recover from the contractor expenses so incurred by him. Section 21 makes the contractor responsible for payment of wages to the contract labour sub-section (2) of S. 21 makes it obligatory on every principal employer to nominate a representative duly authorised by him to be present at the time of disbursement of wages by the contractor. The said sub-section also casts a duty on such representa-

tive to certify the amounts paid as wages as prescribed by the rules sub-section (4) makes the principal employer liable to pay wages in full or the unpaid balance due as the case may be in case the contractor fails to make the payment within the period prescribed. It also enables the principal employer to recover from the contractor the amount to be paid to the labour.

Penalties and Procedure

Chapter VI provides for penalty for any person contravening any provision of the Act or the rules. Section 23 provides that any person prohibiting, restricting or regulating the employment of contract labour, or contravening any conditions of a licence granted under this Act, shall be punishable with imprisonment for a term which may extend to three months, or with fine which may extend to one thousand rupees, or with both. It further provides that in the case of a continuing contravention with an additional fine which may extend to one hundred rupees for every day during which such contravention continues after conviction for the first such contravention.

Miscellaneous

Chapter VII deals with miscellaneous matters, Sub-section (1) S. 28 provides for the appointment of the inspecting staff and sub-section (2), (3) and (4) of S.28 provides regarding the powers vested in him. Section 29 makes it obligatory on the principal employer and contractor to maintaining the registers and records as provided therein. Section 30 provides that the Central Act shall have effect, notwithstanding anything inconsistent therewith contained in any other law or in the terms of any agreement or contract of service or in any standing orders applicable to the establishment whether made before or after the commencement of the Act. No doubt the said section also saves any agreement or contract or standing order whereunder the contract labour gets more benefits than those conferred on them under the Act.

Section 35 gives power to the appropriate Government to make rules for carrying out the purpose of the Act and also in respect of various other matters mentioned in cls. (a) to (p) of sub-section (2).

Chapter 29

THE BEEDI AND CIGAR WORKERS (CONDITION OF EMPLOYMENT) ACT, 1966

IN 1929 A Royal Commission of Labour in India was appointed to make a detailed investigation of labour problems. The commission investigated the conditions in various industries including the beedi-making industry and submitted its report in June 1931, revealing the deplorable state of affairs which prevailed in this industry. As mentioned in the said report, the commission had at that time recommended the enactment of a separate Act for these beedi workers. Even the Labour Investigation Committee appointed in February 1944 to investigate conditions of employment in respect of various industries including the conditions of workmen in the beedi, cigar and cigarette industries found that the working conditions in the beedi industry had remained the same. The beedi and cigar labour satisfied many of the criteria of sweated labour such as sub-contract system, long hours, insanitary working conditions, home-work (in beedi), employment of women and children, irregularity of employment, low wages and lack of bargaining power.

The conditions prevailing in the province of Bombay, so far as sanitation, light and ventilation were concerned, were of beggar

description. They were dark, dingy places with very few, if any, windows and the approaches were very insanitary. The workers were huddled together—men, women and in some cases children—and there was hardly any space to move. Most of the workshops had no lavatories and where there were, they were in a most deplorable condition. Some of the workshops had low wooden ceilings above, under which some workers sat and carried on their work. These were not usually reached by staircases and the workers had to go up with great difficulty. The Committee recorded its conclusion by saying that the matters requiring immediate attention in the beedi and cigar industries were the unhealthy working conditions, long hours of work, employment of women and children, deduction from wages and the sub-contract system of organisation. It was desirable to abolish the outwork system and to encourage establishment of big factories, if protective labour legislation was to be enforced with any degree of success.

It was assumed, as can be seen from the two decisions by the High Court of Bombay in *The State v. Attsaheb Kastm Tamboli*¹ and by the High Court of Patna in *Ram Chandra Prasad v. State of Bihar*,² that the Factories Act, 1948, would cover those establishments in which beedi making was carried on because the expression “employed” in S. 2(1) of the Factories Act included mere engagement or occupation in a manufacturing process without any contract giving rise to a relation of master and servant. Unfortunately, this assumption was found to be wrong because when the matter was finally taken up before the Supreme Court a restricted interpretation was put on the definition of the term “worker” in S. 2 (1) of the Factories Act. In *Chintamanrao v. State of M. P.*³ it was held that even though S. 2 (1) defined a worker as a person employed “directly or through any agency” it could be given only a restrictive interpretation. The expression “employed” was interpreted as covering that relation between “employer” and “employee” where the employment was under a contract of service. The contract of service was to be decided by the usual *prima facie* test of the power of control of the master. In view of this common law concept of master and servant relationship as decided by that *prima facie* test of control which was evolved in the context of determination of tortious liability of the master for the act of the servant, the

¹ A. I. R. 1955 Bom. 209

² A. I. R. 1957 Pat. 247

³ 1958, II L. L. J. 252

servant, the sattedars or workers of the sattedars were held not to be workers within the meaning of this restrictive test.

From this, it is obvious that because of the restricted interpretation given to the definition of the term "worker" in S. 2 (1) of the Factories Act, 1948, and under S. 2 (s) of the term "workman" in the Industrial Disputes Act, 1947, the Labour employed in the beedi industries, even though it was employed in the manufacturing process, was denied these benefits of the Factories Act and of this vital piece of Industrial legislation like the Industrial Disputes Act, if the employment was as contract labour or as home-worker. The power of control by way of rejection of sub-standard beedies was sure to be exercised even in case of this part of the labour force working in this industry, but so long as they were not working on the employer's premises under a contract of employment, the restricted definition came in their way from getting the same rights and benefits which their counterparts who were employed under a direct contract of employment by the employer obtained.

The legislature, however, with a view to prevent circumvention of the provisions of the Factories Act, and to secure to the persons working in establishments where manufacturing process was carried on adequate safeguards where necessity was felt, had authorised the State Government to issue notification under S. 85 of the Factories Act, to declare any place which did not fall within the definition of "factory" to be a factory and to make all or any of the provisions of the Act applicable thereto. However, the difficulty of invoking S. 85, which would extend benefit even to the deemed workers and even to premises which did not satisfy the test of the term factory, was that it was dependant on the notification being issued by the State Government. Therefore, unless such a notification was issued, these beedi workers continued to remain sweated labour working under the same unhygienic conditions even though their counterparts who were employed under regular contract of service with the employer could get these benefits provided they were employed on the premises which came within the definition of the term factory.

Thus contract labour or the deemed workers, who did identical work could not get any benefit of this labour welfare measure and they continued to work in such unhygienic conditions only because of the fact that this relevant statute was interpreted in a restrictive manner to cover only such employment which was under a contract of master and servant and the test of contract of service was the common law test of the master's control which was evolved in the context of tortious liability cases.

Objects of the Act

This Act, therefore, seeks to prevent the mischief which had arisen because of the tendency on the part of the employers to convert their concerns into smaller units so as to escape from the provisions of the Factories Act. The Act, had to be passed also because of the two prominent features of this industry where the manufacture of beedi was done through contractors and by distributing work in the private dwelling houses where the workers were given raw materials by the employers or contractors. In view of this restrictive definition of the term "worker" in S. 2(h) of the Factories Act, 1948, such contract labour and such home-workers could not be deemed to be workers, and they were deprived of their rights under this labour welfare measure. Labour was also unorganised and unable to look after its own interests. Resource to S. 85 by the State Government or even when a special Act was enacted in some States to regulate the conditions of these workers was not found to be helpful in view of the high mobility of this industry which continued to move to such areas where no such laws prevailed. That is why parliament had to enact this as a comprehensive labour welfare measure for giving just conditions of employment to these exploited workers.

The Act has been extended to the whole of India except the State of Jammu & Kashmir under S. 1 (2) and it comes into force in different States when the notification in that behalf is issued by the State Government. Different States have now brought the Act into force by notifications in this behalf.

Definitions

Sections 2(d), 2(e), 2(f), and 2(g) and 2(m) defines the employer-employee relationship.

Section 2(f) defines an "employee" to mean a person employed directly or through any agency, whether for wages or not, in any establishment to do any work, skilled, unskilled, manual or clerical, and includes—

- (i) any labour who is given raw materials by an employer or a contractor for being made into beedi or cigar or both at home (hereinafter referred to in this Act as "home-worker"); and
- (ii) any person not employed by an employer or a contractor but working with the permission of, or under agreement with, the employer or contractor.

Section 2(g) defines "employer" to mean—

- (a) in relation to contract labour, the principal employer; and
- (b) in relation to other labour, the person who has the ultimate control over the affairs of any establishment or who has, by reason of his advancing money, supplying goods or otherwise, a substantial interest in the control of the affairs of any establishment, and includes any other person to whom the affairs of the establishment are entrusted, whether such other person is called the managing agent, manager, superintendent or by any other name.

Section 2(d) defines a "contractor" to mean a person who, in relation to a manufacturing process, undertakes to produce a given result by executing the work through contract labour, or who engages labour for any manufacturing process in a private dwelling house and includes a sub-contractor, agent, munshi, thekedar or sattedar.

Section 2(c) defines "contract labour" to mean any person engaged or employed in any premises by or through a contractor, with or without the knowledge of the employer, in any manufacturing process.

Section 2(m) defines "Principal employer" to mean a person for whom or on whose behalf any contract labour is engaged or employed in any establishment.

From all these definitions it is obvious that S 2(f) not only defines an employee in a restricted manner as in S.2(1) of the Factories Act as a person employed directly or through any agency, but it extends the scope of this definition by including two other categories mentioned therein. Under the first inclusion a "home-worker" is in terms included who is given merely raw material by the employer or the contractor for being made into beedies or cigars or both at home. Under the second inclusion, any person not employed by the employer or the contractor, working with the permission or under an agreement with the employer or his contractor is in terms covered. From the second inclusive clause of S.2(f) it is abundantly clear that the substantive part of the definition of the term "employee" in S.2(f) is itself wide enough to cover any person employed directly or through any agency. Therefore, even where the agency is of the contractor, the contract labour is in terms covered. In addition to the contract labour, a home-worker as well as any person even though not employed by the employer or the

contractor who works with the permission of or agreement with such an employer or contractor is also covered.

The definition of the term "contract labour" is wide enough to cover any person employed or engaged in the premises in any manufacturing process even if the employment is by or through a contractor and with or without the knowledge of the employer. The term "contractor" in relation to the manufacturing process covers not only the person who undertakes to produce a given result by executing work through contract labour but also one who engages labour for any manufacturing process in any private dwelling house. It further includes sub-contractor, agent, munshi, thekedar and sattedar. In relation to all such contract labour S.2(g) defines the principal employer as the employer.

Thus the employer, employee relationship which is envisaged under this Act under Ss. 2(f) and 2(g) is not only that of employment under a direct contract of service. The definition is wide enough to cover all cases of employment which is brought about by employer directly or through any agency in any such establishment. Even persons employed as contract labour, home-workers and those working with permission or under an agreement with the employer or the contractor are covered. That is why the term "employer" is defined as the principal employer for whom or on whose behalf the contract labour is engaged in the establishment or the ultimate employer or the ultimate master who controls the affairs of the establishment. The legislature has thus looked to the economic realities and has not restricted the employer-employee relationship to one merely under contract of service, but has extended the same to cover the entire labour force which is directly or through any agency required or allowed to work in the establishment or at home. As the employer controls the establishment as such of which the employee is a part and parcel as a limb thereof, it is the real master who controls the affairs of the establishment that is treated as the employer, ignoring the fact that the immediate employer may be the contractor or any other agent who gets work of the establishment done through labour force by such agency. So long as the particular labour works for the manufacture or the industry of this employer he is regarded as the employee of such employer.

In *Chhottabhai Purushottam Patel, Beedi Manufacturers of Bhandara and Others v. State of Maharashtra*¹ the Constitutional validity of the Act was challenged in the High Court. One of the points raised

¹ 1962, I. L. L. J. P. 130

by the petitioners was that the provisions of the Act interfere with the freedom of contract and trade of the petitioner in a manner which is beyond the scope permitted by the reasonable restrictions in Cl. (6) of Art. 19. As regards this point, it was held by their Lordships that the provisions of sub-cl. (a) of cl. (g) of S. 2 and the provision of cl. (m) of S. 2 of the Act are invalid as in excess of the requirements of the situation but are likely to defeat the very object of this legislation. As a consequence the words "in relation to other labour" contained in sub-cl. (b) of cl. (g) of S. 2 are to be treated as deleted. The rest of the Act is upheld as legal and valid and is to be read with the two clauses mentioned above as being absent in the section of definitions. All the rules framed under the Act are also upheld as legal and valid.

A similar point was raised in Gujarat High Court in *Gujarat Beedi Karkhana Owners Association and others v. Union of India and Others*.⁵ It was held by their lordships that the restrictions imposed must be held to be regulatory, commensurate with the object of rooting out the exploitation found to be existing. Secondly, as there is no freedom to exploit, there is no foundation for the contention that there was a restriction of freedom of trade by involving fundamental rights under Art. 19 (1) (g). Thirdly, the Act cannot also be attacked on the ground that the minimum member has not been prescribed and that an artificial concept of employment has been given. Even the provisions of home-workers can never be attached on the ground of unreasonable restriction.

As regards the term "premises" we have to turn to three definitions in S. 2 (h), 2 (i) and 2 (n). These three definitions are as under—

• "Establishment" means any place or premises including the precincts thereof, in which or in any part of which manufacturing process connected with the making of beedi or cigar or both is being, or is ordinarily carried on and includes an industrial premises [S. 2 (h)].

"Industrial premises" means any place or premises (not being a private dwelling house) including the precincts thereof, in which or in any part of which any industry or manufacturing process connected with the making of beedi or cigar or both is being or is ordinarily carried on with or without the aid of power [S. 2 (i)].

⁵ 1972, I. L. L. J. P. 253 (G.H.)

“Private dwelling house” means a house in which persons engaged in manufacture of beedi or cigar or both reside [S. 2 (n)].

The expression “industrial premises” in S. 2 (i) bodily incorporates the entire definition of the “establishment” in S. 2 (h). Because of the exclusion of a private dwelling house from this definition, it is abundantly clear that the expression “industrial premises” is in one sense narrower than the term “establishment” as it excludes a private dwelling house. On the other hand, it is wider than the term “establishment” because it not only covers premises used for the manufacturing process connected with the making of beedies or cigar, etc., whether with or without the aid of power but those used for the entire industry as such. The industrial activity with the co-operation of capital and labour would be in the wider sense and it would cover even other persons than those participating in the manufacturing process as for example, clerical staff, watchman, etc. The legislature has advisedly used the expression industry connected with the making of beedi or cigar or both and not only the manufacturing process connected therewith.

Licenses

Sections 3 to 5 are the licensing provisions. According to S. 3 no employer shall use or allow to be used any place or premises unless he holds a valid license issued under this Act and no such premises shall be used except in accordance with the terms and conditions of such license. For the purpose of issuing such licenses as also for the purpose of performing all or any of the functions under the Act, the State Government is authorised to appoint a competent authority by notification in the official Gazette.

Section 4 enjoins on a person who wants to use or allows to be used any place or premises as industrial premises to make an application in writing to the competent authority, in such form and on payment of such fees as may be prescribed for a licence to use, or allow to be used, such premises as an industrial premises. Sub-section (3) of S. 4 vests the competent authority with the power to decide whether to grant or refuse a licence, and while doing so, it is required to have regard to the matters mentioned in cls. (a) to (c) of that sub-section. They relate to the suitability of the place or premises, the previous experience of the applicant, the financial resources of the applicant including his financial capacity to meet the demands arising out of the provisions of the laws for the time being in force relating to welfare of labour, the disclosure whether the application

is made *bona fide* on behalf of the applicant himself or is *benami* for any other person and the welfare of the labour in the locality, the interests of the public generally and such other matters as may be prescribed. Sub-section (4) of S. 4 lays down the time limit and validity of a licence and the method and manner of renewal thereof. Sub-section (5) of S. 4 lays down that the competent authority shall not grant or renew a licence unless it is satisfied that the provisions of the Act and the rules made thereunder have been substantially complied with. Sub-section (6) deals with the suspension and cancellation of a licence and the method thereof. Sub-section (7) deals with the State Government's power to issue directions and prescribed conditions under which a licence could be issued. Sub-section (8) enjoins a duty on the competent authority to pass an order in writing with reasons when a licence is being refused or is not renewed.

Section 5 deals with the appeals against orders refusing to grant or renew a licence or cancelling or suspending the same.

Health and Welfare Measures

Sections 8 to 16 deal with the provisions regarding health and welfare. Section 8 deals with the topics of "cleanliness". Section 9 deals with "ventilation". Section 10 deals with "overcrowding", S. 11 with drinking water, S. 12 with latrines and urinals, S. 13 with washing facilities in case of certain processes, S. 14 with creches, S. 15 with first-aid and S. 16 with canteens. These are the general provisions regarding health and welfare which are to be found in the Factories Act and which are made applicable to industrial premises. Section 8 requires every industrial premises to be kept clean and free from effluvia arising from any drain, privy or other nuisance and it shall maintain such standard of cleanliness including whitewashing, colourwashing, varnishing or painting, as may be prescribed. The other provisions depend on the rules as prescribed. Under the relevant rules, elaborate details are prescribed and in the relevant cases even the number of workers employed in the premises on the basis of which these amenities are to be provided has been regulated.

Conditions of Employment

Section 17 to 25 provide for matters regarding the working hours, wages for overtime work, interval for rest, spread-over, weekly holidays, notice for periods of work with which working hours shall correspond, prohibition of employment of children under 14 years and of women and young persons under 18 years during certain

prescribed hours. These provisions are also on the lines of the Factories Act and they apply only to industrial premises.

Leave with Wages

Sections 26 and 27 deal with the topic of annual leave with wages. According to S. 26, every employee shall be allowed annual leave with wages—in case of an adult, at the rate of one day for every twenty days of work performed by him during the previous calendar year and in the case of a young person, at the rate of one day for every fifteen days of work performed by him. Explanation to sub-section (1) of S. 26 provides that the leave shall be exclusive of all holidays, whether occurring during or at the beginning or at the end of the period of leave. Proviso to sub-section (4) of S. 26 provides that the total number of days of leave that may be carried forward to a succeeding year shall not exceed thirty in the case of an adult or forty in the case of a young person.

Section 27 provides that an employee shall be paid wages for the leave allowed to him under section 26 at the rate equal to the daily average of his total full time earnings for the days on which he had worked during the month immediately preceding his leave, exclusive of any overtime earnings and bonus but inclusive of dearness and other allowances. Explanation II to S. 27 in terms provides that for the purpose of determining wages payable to a home worker during leave period or for the purpose of payment of maternity benefit to a woman home-worker, "day" shall mean any period during which such home-worker was employed, during a period of twentyfour hours commencing at midnight, for making beedi or cigar or both. In order that no difficulty can be experienced for computation of the "day" of such home-worker, this explanation has been enacted.

Extension of Benefits of the other Acts

Section 28 extends benefit of the Payment of Wages Act, when a notification is issued in respect of the employees in the establishments or a class of establishments. This benefit is thus available to all establishments and is not restricted to industrial premises.

Section 31 provides for security of service by providing that no employer shall dispense with the services of an employee who has been employed for a period of six months or more, except for a reasonable cause, and without giving such employee at least one month's notice or wages in lieu of such notice. The proviso enacts that such notice shall not be necessary if the services of such employee are dispensed with on a charge of misconduct supported

by satisfactory evidence recorded at an inquiry held by the employer for the purpose. Under S. 31 (2) (a) the employee so discharged, dismissed or retrenched may appeal to such authority and within such time as may be prescribed either on the ground that there was no reasonable cause for dispensing with his services or on the ground that he had not been guilty of misconduct as held by the employer or on the ground that such punishment of discharge or dismissal was severe. This appellate authority can under S. 31 (2) (b) reinstate the employee with or without back wages or direct payment of compensation and under cl. (3) the decision of the appellate authority is final and binding on both parties and shall be given effect to within the time specified by the appellate authority. Section 33 provides for penalties, if the order of reinstatement or compensation is not carried out. Therefore, this section confers the benefit of security of service to all employees and, therefore, it applies to all establishments.

Section 37 (1) and (2) extend benefit of the Industrial (Standing Orders) Act, 1946. If the number of persons employed in the industrial premises is 50 or more the benefit is available without any notification, while if the number is less, the notification of the State Government would be necessary.

Under S. 37(3), notwithstanding anything contained in the Maternity Benefit Act, 1961, the provisions of that Act shall apply to every establishment as if such establishment were an establishment to which that Act has been applied by a notification under Sub-Section (1) of S. 2 thereof. The proviso makes appropriate provisions for the homemaker so that the home-worker would get the benefit of that Act. It should be noted that Industrial Employment Standing Orders under S. 37 (1) and (2) apply to industrial premises, while extension of the Maternity Benefit Act under S. 37 (3) is to all establishments.

Under S. 38 (1), safety provisions of Chapter IV of the Factories Act are made applicable to industrial premises, and S. 85 of the Factories Act being also made applicable, it is left to the State Government to issue the relevant notification for that purpose. Under S. 38 (2) nothing in any law in this connection relating to the regulation of the conditions of work of workers in shops or commercial establishments shall apply to any establishment to which the Act applies.

Under S. 39 (I), the Industrial Disputes Act, 1947, shall apply to matters arising in respect of every industrial premises. Under

S. 39 (2), however, it is provided that notwithstanding anything contained in sub-section (1), a dispute between an employer and an employee in relation to—

- (a) the issue by the employer of raw materials to the employees;
- (b) the rejection by the employer of beedi or cigar or both made by an employee;
- (c) the payment of wages for the beedi or cigar or both rejected by the employer;

shall be settled by such authority and in such summary manner as the State Government may by rules specify in this behalf. Under S. 39 (3) an appeal is provided to the appellate authority whose decision is made final.

Section 40 provides that the provision of the Act shall have effect notwithstanding anything inconsistent therewith in any law or in the terms of any award agreement or contract of service whether made before or after the commencement of the Act.

Exemption Provision

Under Section 41, the State Government can exempt, subject to the conditions and restrictions laid down, any class of industrial premises from all or any of the provisions of the Act or the Rules, except that in the case of women employees there shall be no power to exempt from the provisions regarding the annual leave with wages, maternity benefits, creches, wages, rejection of beedi or cigar and night work.

Under Section 43 the self-employed persons in private dwelling houses are exempted, unless such person carries on manufacturing work in such private dwelling house with the assistance of persons who are not his spouse and children or he himself is an employee of some other employer to whom the Act applies.

Chapter 30

INDUSTRIAL DISPUTES ACT, 1947

AT THE CLOSE of the first world war (1914-18) there was a great outbreak of Industrial unrest on a large scale which led to the passing of the first Indian Trade Disputes Act by the Government of India after exploring the possibility to *provide some machinery for the settlement of industrial disputes*. This Act was known as the Trade Disputes Act, 1929. The objects and reasons of this Act state that enquiries made with this objective in the year 1920 led to the conclusion that the condition then existing in legislation for this purpose were not likely to be affected but that succeeding years saw a distinct change in the position through the growth of organization of industrial workers and the increasing influence exercised by public opinion on the courts of dispute. Thus this Act came to be taken seriously in hand and passed. The main Chapters 3-4 of this Act related to the establishment of tribunals for the investigation and settlement of trade disputes and the material had been taken generally from the British Industrial Court Act of 1909. The Act provided for some sort of a *tribunal* to which the industrial disputes may be referred and here it differed from the *British Act* in as much as the said Act sets up a *standing industrial court*, whereas the *Indian Act* provided for *concillation boards* which were to be appointed *ad hoc* like the court of inquiry in order to deal with disputes.

There were various amendments to the Trade Disputes Act. During World War II several emergency measures were adopted by the Central Government and in the beginning of 1952, Rule 81 A was added to the Defence of India Rule with a view to restrain strikes and lock-outs. This new Rule gave the Government power to make orders prohibiting strikes, or lock-outs with regard to any trade disputes, unless reasonable notice was given. The Government was also empowered to refer to conciliation or adjudication any disputes and to enforce decisions of the adjudicators. In the middle of 1942, the Central Government promulgated an order under this new Rule making 14 days' previous notice essential for strikes or lock-outs. Eventually, the *Industrial Disputes Act* 1947 was passed which embodies the important principles of Rule 81 A and keeps the main provisions of the Trade Disputes Act, 1929. This Act was really the first legislative measure under the Five Year Labour Programme of the Government of India. It applies to the whole of India except the State of Jammu and Kashmir. This Act introduced the principles of compulsory arbitration and prohibited strikes without notice in respect of public utility services. It introduced the institution of Works Committee and Industrial Tribunals.

The Working of the Industrial Disputes Act, 1947, revealed the need for a Central Appellate Authority which could, through its decisions, co-ordinate the activities of the various Industrial Tribunals constituted by the Central and State Governments. Divergent views have been taken by Tribunals on important points such as retirement benefits, profit-sharing, etc. resulting in difficulties in the case of undertakings with branches or transferable staff where different decisions are given by different Tribunals. Thus a need was felt for constituting an Appellate Tribunal and to fulfil this need the Industrial Disputes (Appellate Tribunal) Act of 1950 was passed and the Industrial Disputes (Appellate Tribunal) Rules, 1951, were framed. This was ultimately repeated by the Industrial Disputes (Amendment & Miscellaneous Provisions) Act, 1956 which provides for labour courts Tribunal and National Tribunals. The Industrial Disputes Act was further amended in 1964 to provide for the following—

(1) Prohibition of strikes and lockouts during the arbitration proceedings.

(2) Appointment of an Umpire in the case of difference of opinion between the arbitrators.

(3) Termination of an award or settlement by proper notice only by a majority of workmen.

(4) A revised procedure for the recovery of moneys due from an employer and provision of limitation in making applications for recovery of the money due.

(5) Payment of full compensation to workmen in cases of closure on the expiry of lease or licence.

(6) The definition of the term "continuous service" in section 25B has been amended so as to provide that if a workman has worked for 240 days within a period of 12 months whether continuously or intermittently he will be deemed to have completed one year's continuous service.

Consequences of Industrial Disputes

A serious consequence of an industrial dispute is the loss in general output. In the case of strikes it is not only the workers who suffer but also the employers and often the public. All strikes are not passive and some result in violence and destruction of property and the endangering of public safety. Employers suffer from loss of profits and heavy expenditure and loss of time in connection with the strike as well as the training of new employees. Thus it is very important to prevent industrial disputes by means of legislation as well as other timely action.

Causes of Industrial Disputes

Industrial disputes are found to rise mainly from the following—

- (1) Wages and allowances;
- (2) Bonus;
- (3) Personnel; and
- (4) Leave and hours of work.

Psychological; political as well as economic factors are largely responsible for strikes in our country.

Definitions

The following are some of the important definitions in the Industrial Disputes Act of 1947—

"Employer" means—

"(1) in relation to an industry carried on by under the authority of any department of the Central Government or a State Government, the authority prescribed in this behalf, or where no authority is prescribed, the head of the department

(ii) in relation to an industry carried on by or on behalf of a local authority, the Chief Executive Officer of that authority."

Appropriate Government

For the purpose of the administration of the Act, there is a specific definition of appropriate Government, defined under S. 2 (a) of the Act. Broadly, the industries carried on by or under the authority of the Central Government, railways, mines, ports and the statutory Corporations established under the Acts of Parliament are under the Central sphere and the Central Government is the appropriate Government for such industries. The remaining industries are under the state sphere and the relevant State Government, will be the appropriate Government for them. Our constitution being of a federal character, this distribution of power has become necessary.

However, disputes regarding the appropriate Government often arises. For example, where a mine is in the Central sphere but its workshop falls within the State sphere, the question arises whether the Central or State Government is the appropriate Government. A factory may be in one State but its head office may be in another. In such a situation, whether this or that State is the appropriate Government has to be decided. According to the Supreme Court, there must be nexus between the dispute and the territory of the State and not between the industry and the Government. Further, the place of substantial cause of action and the residence of parties are considered sufficient for such jurisdiction. In the Heavy Engineering Corporations Case¹ the Government of India held 99 per cent of the shares in the company and the question arose whether the Central Government or the Government of the State where the factory was situated, was the appropriate Government. The Supreme Court held that since it was a company and not a Government department, the State Government was the appropriate Government. Mere holding of the shares by the Central Government did not make it an industry carried on by or under the authority of the Central Government.

"Award" has been defined under S. 2 (b) to mean an interim or a final determination of any industrial dispute or of any question relating thereto by any labour court. Industrial Tribunal or National Industrial Tribunal and includes an arbitration award made under Sec. 10-A.

"Workman" means—

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"any person (including an apprentice) employed in any industry to do any skilled or unskilled, manual, supervisory, technical or clerical work for hire or

¹ 1969, II L. L. J p. 549.

reward, whether the terms of employment be express or implied, and for the purposes of any proceeding under this Act in relation to an industrial dispute includes any such person who has been dismissed, discharged or retrenched in connection with, as a consequence of that dispute, or whose dismissal, discharge or retrenchment has led to that dispute, but does not include any such person—

- (i) who is subject to the Army Act, 1950, or the Air Force Act, 1950, or the Navy (Discipline) Act 1934; or
- (ii) who is employed in the police service or as an officer or other employee of a prison; or
- (iii) who is employed mainly in managerial or administrative capacity; or
- (iv) who being employed in a supervisory capacity draws wages exceeding five hundred rupees per mensem or exercises, either by the nature of the duties attached to the office or by reason of the powers vested in him, functions mainly of a managerial nature.

In interpreting this definition, the courts are faced with the following problems—

- (1) whether a discharged workman is a “workman”;
- (2) distinction between independent contractor and workman; and
- (3) technical workman.

As regards the discharged workman, the definition expressly covers the discharged, dismissed and retrenched workman, where such actions are taken in connection with an industrial dispute, or if an industrial dispute, is raised as a consequence of such actions. In *Central Provincial Transport Services Ltd. v. R. G. Paiwardhan*,² the Supreme Court held that the definition of an employee under the Central Provinces and Berar Industrial Disputes Settlement Act, 1947, and Industrial Disputes Act, 1947, are in *part-materia* and that the question whether an ex-workman was covered by the definition has been concluded by the Western India Automobile Company's case.

As to the distinction between a workman and an independent contractor, it rests mainly on the employer's power of control and supervision over the method and manner of the work to be done. In *Dhrangadhra Chemical Works Ltd. v. State of Shaurashtra and others*.³ Agaris (a type of unskilled worker) were engaged by the salt company to work on plots of land to manufacture salt under a contract under the general supervision and control of the officers of the company. But they were allowed to employ some assistants to work under them who were to be paid by the Agaris themselves. Further there were no fixed working hours for the Agaris. The Supreme Court found that these Agaris were workmen although they had no fixed hours of work

² 1957, I. L. L. J. 27.

³ 1957, I. L. L. J. 477.

and were allowed to take assistants and pay them from their own pockets.

As regards the technical workman, the category has been specifically included in the definition by an amendment in 1957. In *Workmen of Dimakuchi Tea Estate v. Management of Dimakuchi Tea Estate*, the Supreme Court held that the doctor's work being neither clerical nor manual, he was not covered by the definition of workman. It was further held that his work was of a technical nature and, therefore, he did not fall under the old definition of workman. But as a result of this change in the definition the technical personnel, such as physicians, were held to be workmen under the Industrial Disputes Act in *Bengal United Tea Co. v. Ram Labhya and others* by the Assam High Court. The Court pointed out that in the Dimakuchi Case the doctor's work was held to be technical and not clerical or manual and due to the fact that the technical personnel had been expressly included in the definition, the assistant medical officer in this case would be a workman.

In *Lloyds Bank Ltd. v. P.L. Gupta and others*⁴, the Supreme Court, distinguishing the characteristics of supervision work, pointed out that mere checking of entries in ledgers or statements of accounts, did not amount to supervision duty. There were ordinary incidents of classical work.

The difficulties also arise in the case of certain workers as to whether they are carrying out managerial or administrative duties or not. If a person has power of recruitment, disciplinary action, promotions, representing the management to the world at large, or has a voice in the management of the business as such, then he is not considered to be a 'workman'. Although rigid or fixed tests are not possible certain broad tests are laid down by the Supreme Court for determining whether a person is carrying out a managerial function.

Industry

The term 'industry' has been defined under Sec. 2 (j) to mean any business, trade, undertaking, manufacture or calling of employers and includes any calling, service, employment, handicraft or industrial occupation or avocation of workmen.

The definition is in two parts. The first part of the definition gives the statutory meaning of industry, whereas the second part deliberately refers to several other items of industry and brings them in the definition in an inclusive way.

⁴ 1961, I. L. L. J. 18.

The Supreme Court had to interpret this definition with reference to a wide range of employment such as employees employed for carrying out regal functions of the State, local authorities, charitable hospitals, professions, educational activities, sports clubs, religious institutions, associations connected with trade or business, etc. It has, therefore, evolved two types of tests, in order to determine whether an activity falls within the meaning of "industry" as defined in S. 2 (j).

Negative Tests

- (1) Presence or absence of capital investment is not decisive.
- (2) Presence or absence of profit motive is not relevant.
- (3) *Quid-pro-quo* is not necessary.

Positive Tests

- (1) Co-operation of capital and labour.
- (2) Habitual and organised activity analogous to trade or business.
- (3) Satisfaction of some want of community or a part of it, or in other words, production of material or material services.

These, however, are not exhaustive tests.

Municipal Services

In *Corporation of City of Nagpur v. Their workmen*,⁵ a distinction between regal function of the State and municipal functions was drawn, and it was held that it was an industry. The contention of the municipality that it did not answer the definition of industry was rejected so far as its activities were analogous to a business or trade.

Charitable Hospitals

In *State of Bombay, v. Hospital Mazdoor Sabha and others*,⁶ the test was laid down to decide whether a particular human activity was an industry or not. The Supreme Court held that the activity of running hospitals was not a regal activity of the State, hence it would fall within the definition of industry in as much as an activity would be industry if run by private citizens. It is the character of the activity which decides the question, and who conducts it would not make any material difference. Likewise, the capital investment and profit motive were also considered unessential.

In *Management of Safdarjung Hospital and other v. K. S. Sethi*, this decision is overruled by the Supreme Court. The main reason

⁵ 1960, I L. L. J. 523.

⁶ 1960, I. L. L. J. 251.

pointed out by the Court is that it was wrong to split up the definition of "industry" into two parts, one being framed from the viewpoint of the worker and the other from the view-point of the employer.

Educational Activities

In *University of Delhi and another v. Ram Nara and others*,⁷ it was held that education being a mission aimed at creating a well-educated healthy young generation imbued with a rational, progressive outlook on life, and not a profession, this activity could not come under the scope of the definition of industry.

Professional Activities

In *National Union of Commercial Employees v. M. R. Meher*,⁸ it was held that a solicitors' firm was not an "industry". This view was taken mainly on the ground that in the result, i.e. the legal advice given by the solicitor, there was no contribution from the labour as it mainly came from the personal and professional skill, training and experience of the solicitors and their staff had hardly anything to do with it. The profit motive was considered irrelevant here. In the case of a Chartered Accountants' firm also, the same view was taken.

Associations Connected with Industries

In *Management of Federation of Indian Chambers of Commerce and Industry v. Their workman Shri R.K. Mittal*,⁹ the Supreme Court held that the Appellant Federation was an industry as although by itself it was not carrying on any trade or business its activities were an aid to trade and business.

Clubs

In *Madras Gymkhana v. Their workmen* the Supreme Court came to the conclusion that the activities carried on for the purpose of pleasure and sport were not "industries". The main object of the club was entertainment of its members. The same ratio was extended to *The Cricket Club of India v. Their workmen* by the Supreme Court.

Religious or Humanitarian Institutions

In *Bombay Panjarapole v. Its workmen*,¹⁰ the Supreme Court came to the conclusion that the said Panjarapole was an "industry"

⁷ 1963, II L. L. J. 335

⁸ 1962, I L. L. J. 241

⁹ 1971, II L. L. J. 630

¹⁰ 1971, II L. L. J. 393

although its object was to provide shelter to infirm and unwanted cattle.

The Supreme Court has in the recent decision in *Bangalore Water Supply and Sewerage Board v. Rajappa* (1978 (1) LLJ 339) widened the scope of the term industry as follows:

1. Wherein any systematic activity organised by co-operation between employer and employee the direct and substantial element is commercial for the production and/or distribution of goods and services calculated to satisfy human wants and wishes, not spiritual and religious needs, but inclusive of material things or services geared to celestial bliss that is making on large scale *prasad* or food, *prima facie*, there is an industry in that enterprise.
2. Absence of profit motive or gainful objective is irrelevant, be the venture in the public, joint, private or other sector.
3. The true focus is functional and the decisive test is the nature of the activity with special emphasis on employer employee relations.
4. If the organisation is a trade or business, it does not cease to be one because of philanthropus animating the undertaking.

“*Industrial dispute*” means —

“any dispute of difference between the employers and employees, or between employers and workmen, or between workmen and workmen, which is connected with the employment or non-employment or the terms of employment or with the conditions of labour, of any person”.

Dismissal Deemed Industrial Dispute—

By an amendment in 1965, any dispute or difference between the workmen and his employer connected with, or arising out of discharge, dismissal, retrenchment or termination of the services of an individual workman shall be deemed to be an industrial dispute notwithstanding that no other workman nor any union of workmen is a party to dispute. (S. 2-A)

“*Lay off*” (with its grammatical variations and cognate expressions) means—

the failure, refusal or inability of an employer on account of shortage of coal, power or raw materials or the accumulation of stocks or the breakdown of machinery or for any other reason to give employment to a workman whose name is borne on the muster rolls of his industrial establishment and who has not been retrenched;

“*Public utility service*” means—

- (i) any railway service or any transport service for the carriage of passengers or goods by air;

- (ii) any section of an industrial establishment, on the working of which the safety of the establishment or the workmen employed therein depends;
- (iii) any postal, telegraph or telephone service;
- (iv) an industry which supplies power, light or water to the public;
- (v) any system of public conservancy or sanitation;
- (vi) any industry specified in the First Schedule which the appropriate Government may, if satisfied that public emergency or public interest so requires, by notification in the official Gazette declare to be a public utility service for the purposes of this Act, for such period as may be specified in the notification:

Provided that the period so specified shall not, in the first instance, exceed six months but may, by a like notification, be extended from time to time, by any period not exceeding six months, at any one time if in the opinion of the appropriate Government public emergency or public interest requires such extension.

“Retrenchment” means—

the termination by the employer of the service of a workman for any reason whatsoever, otherwise than as a punishment inflicted by way of disciplinary action but does not include—

- (a) voluntary retirement of the workman; or
- (b) retirement of the workman on reaching the age of superannuation if the contract of employment between the employer and the workman concerned contains a stipulation in that behalf; or
- (c) termination of the service of a workman on the ground of continued ill-health.

“Settlement” means—

a settlement arrived at in the course of conciliation proceeding and includes a written agreement between the employer and workmen arrived at otherwise than in the course of conciliation proceeding where such agreement has been signed by parties thereto in such manner as may be prescribed and a copy thereof has been sent to the appropriate Government and the conciliation officer.

“Lock-out” means—

“the closing of a place of employment, or the suspension of work, or the refusal by an employer to continue to employ any number of persons employed by him.”

“Strike” means—

“a cessation of work by a body of persons employed in any Industry acting in combination, or a concerted refusal, or a refusal under a common understanding, of any number of persons who are or have so employed to continue to work or to accept employment.”

Works Committee

This act empowers the appropriate Government to require an employer of any industrial establishment where 100 or more workmen are employed or have been employed on any day in the

preceding twelve months to constitute a Works Committee. This Works Committee must consist of representatives of employers and workmen and the number of representatives of workmen on the Committee should not be less than the number of representatives of the employer. The representatives of the workmen should be chosen from the workman engaged in the establishment and the consultation with the Trade Union, if any, registered under the Indian Trade Unions Act, 1926. The *duty* of the Works Committee is to promote measures for securing and preserving amity and good relations between the employer and workmen and for that purpose to comment upon matters of their common interest or concern and endeavour to compose any material difference of opinion in respect of such matters [S. 3]

Authorities Under the Act

Conciliation Officers are to be appointed by the appropriate Government, by notification in the official Gazette. A conciliation officer may be appointed for a specified area or for specified industries in a specified area or for one or more specified industries and either permanently or for a limited period. The duty of these Conciliation Officers is to mediate and promote the settlement of industrial disputes [S. 4].

Boards of Conciliation are also appointed in a similar manner for promoting the settlement of an industrial dispute. The Board shall consist of a chairman and two or four other members, as the appropriate Government think fit. The chairman must be an independent person and the other members must be persons appointed in equal numbers to represent the parties to the dispute and appointed on the recommendation of such parties. If, however, any party fails to make a recommendation within the prescribed time, the appropriate Government shall appoint such persons as it thinks fit to represent that party. The Board can act notwithstanding the absence of the chairman or any of its members or any vacancy in its number, provided the prescribed quorum is present. Where, however, the appropriate Government has notified the Board that the services of the chairman or any other member have ceased to be available, the Board must not act until a new chairman or member, as the case may be, has been appointed [S. 5].

Courts of Inquiry are to be appointed by the appropriate Government as occasion arises in the same manner with a view to inquire into any matter appearing to be connected with or relevant to an

Industrial Dispute. A Court may consist of one independent person or of such number of independent persons as the appropriate Government may think fit. Where a Court consists of two or more members, one of them shall be appointed as the chairman. The power of the Court to act in the absence of the chairman or any of its members is the same as in the case of a Board of Conciliation [S.6].

Labour Courts, Tribunals and National Tribunals consisting of one person are also appointed by the appropriate Government in a similar manner for the adjudication of industrial disputes. *The National Tribunal* is appointed by the Central Government when it is of the opinion that the questions involved are of national importance or affect industrial establishments situated in more than one State [Ss. 7, 7A (B)].

The second schedule to section 7 provides regarding matters within the jurisdiction of Industrial Tribunals, which are as follows—

- (1) the propriety or legality of an order passed by an employer under the standing orders;
- (2) the application and interpretation of standing orders;
- (3) discharge or dismissal of workmen including retirement of or grant of relief to, workmen wrongfully dismissed;
- (4) withdrawal of any customary concession or privilege;
- (5) illegality or otherwise of a strike or lock-out; and
- (6) all matters other than those specified in the third schedule.

The third schedule to section 7A provides regarding matters within the jurisdiction of Industrial Tribunals, which are as under—

- (1) wages, including the period and mode of payment;
- (2) compensation and other allowances;
- (3) hours of work and rest intervals;
- (4) leave with wages and holidays;
- (5) bonus, profit sharing, provident fund and gratuity;
- (6) shift working otherwise than in accordance with standing orders;
- (7) classification by grades;
- (8) rules of discipline;
- (9) rationalisation;
- (10) retrenchment of workmen and closure of establishment; and
- (11) any other matter that may be prescribed.

An order of the appropriate Government appointing any person as a member of a Board, Court, or Tribunal shall not be called in question in any manner [S. 9].

Notice of Change

Section 9-A of the Industrial Disputes Act prohibits a change in certain specified conditions of service without notifying the

change to the workmen concerned or within 21 days of such notice. It is only reasonable to assume that a change contemplated by this section is one which is prejudicial on which is likely to be prejudicial to the workmen. There is no meaning in placing restrictions on the employer's freedom to make changes which will be beneficial to the workers, as, for example, a rise in the wages. The whole object of the section is, apparently, to prevent unilateral action on the part of the employer changing the conditions of service to the detriment of the employees. From the proviso to the section it is clear that it does not apply to changes brought about under a conciliation settlement. Further, section 9-A could have no application to a case where the change is to become effective only after the workmen have agreed to or opted for the same.

References of disputes to Boards, Courts, or Tribunals may be made by the appropriate Government either (1) on its own initiative or (2) on an application made by parties to an industrial dispute. Where the appropriate Government is of opinion that any industrial dispute exists or is apprehended, it may at any time by order in writing (a) refer the dispute to a Board for promoting settlement thereof or; (b) refer any matter appearing to be connected with or relevant to the dispute to a Court for inquiry; or (c) refer the dispute or any matter appearing to be connected with, or relevant to the dispute, to a Labour Court or to a Tribunal as appropriate for adjudication.

Where the parties to an industrial dispute apply in the prescribed manner whether jointly or separately for a reference of the dispute to a Board, Court, Labour Court, Tribunal or National Tribunal, the appropriate Government, if satisfied that the persons applying represent the majority of each party, shall make the reference accordingly. Where a reference of an industrial dispute has been made by the appropriate Government to a Board or Tribunal as mentioned above such Government may by order prohibit the continuance of any strike or lock-out, in connection with such dispute which may be in existence on the date of the reference [S. 10].

Voluntary Reference of Disputes to Arbitration

Section 10-A of the Industrial Disputes Act provides for the arbitration of industrial disputes. Under this section, the parties to a dispute may, in writing, agree to refer the matter to the decision of an arbitrator or arbitrators to be specified in the agreement. The

arbitration agreement has to be drawn up in the prescribed manner, and copies thereof have to be forwarded to the Government, the Labour Commissioner, and the Conciliation Officer. The Government will then publish the agreement in the Gazette within one month of its receipt.

Procedure and Powers of Conciliation Officers, Boards, Courts and Tribunals

Section 11 (1) gives very wide powers to Arbitrators, Boards, Courts, Labour Courts, Tribunals or National Tribunals by empowering them to follow such procedure as they may think fit, subject, however, only to such Rules as may be made in this behalf by the appropriate Government under section 38 of the Act. It is to be noticed that this discretionary power must be used with cause and must not offend the principles of natural justice. This sub-section, however, does not apply to a conciliation officer whose procedure and powers are indicated in sub-sections (2) and (4).

Section 11 A which has recently been added, the labour courts and tribunals are given power to judge for themselves the justification of discharge or dismissal for misconduct of an employee. The tribunals are also given powers to interfere with the punishment imposed by an employer. The proviso, however, emphasises that the tribunal has to satisfy itself one way or the other regarding misconduct, the punishment and the relief to be granted to workmen only on the basis of the "materials on record" before it.

In the case of *Firestone Tyre and Rubber Co. of India (Pvt) Ltd. v. Their workmen*¹², it was held by the Supreme Court that even after S. 11A employer has a right to justify his action and to adduce evidence before the labour court or the Industrial Tribunal in a case where there was no domestic enquiry held or where the domestic enquiry is found defective.

Duties of Conciliation Officers, Boards, Courts and Tribunals

In the case of all disputes relating to a *public utility service*, conciliation is *compulsory* and where proper notice is given in such a case the Conciliation Officer shall hold conciliation proceedings in the prescribed manner. Conciliation is optional in case of other industrial establishments. *Time limits* have been prescribed to make Conciliation proceedings speedy and is fourteen days in case of a Conciliation Officer and two months in case of a Board of Concili-

¹² 1973, I. L. L. J. p. 278

ation, the period being counted from the date of commencement of conciliation proceedings or the date on which the dispute was referred to the Board, as the case may be.

It is the duty of the Conciliation Officer to bring about a settlement of the dispute and for that purpose to investigate the dispute and all matters affecting the merits of such disputes without delay. He should do all such things as he thinks fit with a view to induce the parties to come to a fair and amicable settlement of the dispute. The duty of a Conciliation Board is also similar. If a settlement of the dispute is arrived at in the course of conciliation proceedings, the Conciliation Officer, or the Board of Conciliation, as the case may be, must send the report thereof to the appropriate Government together with a *Memorandum of the settlement* signed by the parties to the dispute. If, however, no such settlement is arrived at, the Conciliation Officer or the Board of Conciliation must send a *full report* to the appropriate Government. This must be done as soon as practicable after the close of the investigation. The report must set forth the proceedings and steps taken by the Conciliation Officer or the Board for bringing about a settlement. A full settlement of such facts and circumstances, must be made and the opinion of the Officer or Board should be given as to the reasons on account of which a settlement could not arrived at. In case of a Board of Conciliation, the report must also include its recommendations for the determination of the dispute. On the receipt of such a report the appropriate Government may take a reference to a Board, Labour Court, Tribunal or National Tribunal, in case of a report received from a Board [Ss. 12 & 13].

It is the duty of the Court of Inquiry to inquire into the matters referred to it and report thereon to the appropriate Government within six months from the commencement of its inquiry [S. 14].

In case an industrial dispute has been referred to a Labour Court, Tribunal or National Tribunal for adjudication, it shall hold its proceedings expeditiously and submit its awards to the appropriate Government as soon as practicable on the conclusion of the adjudication [S. 15].

Form of Report and Award

The report of a Board or Court must be in writing and signed by all its members. Of course, any member may record a minute of dissent. The award of a Labour Court or Tribunal or National Tribunal must be signed by its presiding officer. Such report or award

shall be published within thirty days from the date of its receipt by the appropriate Government in such manner as it thinks fit [Ss. 16 & 17].

The Binding Force of Settlements and Awards

A settlement arrived at by agreement between the employer and workman otherwise than in the course of conciliation proceedings shall be binding on the parties to the agreement. An arbitration award which has become enforceable shall be binding on the parties to the agreement who referred the dispute to arbitration. A settlement arrived at in the course of conciliation proceedings or an award of a Labour Court, Tribunal or National which has become enforceable is binding on the following persons—

- (a) all parties to the industrial dispute;
- (b) all other parties summoned to appear in the proceedings as parties to the dispute, unless the Board, Labour Court, National Tribunal or Tribunal, as the case may be, records the opinion that they were so summoned without proper cause;
- (c) where a party referred to in clause (a) or clause (b) is an employer, his heirs, successors or assigns in respect of the establishment to which the dispute relates;
- (d) where a party referred to in clause (a) or clause (b) is composed of workmen, all persons who were employed in the establishment or part of the establishment, as the case may be, to which the dispute relates on the date of the dispute and all persons who subsequently become employed in that establishment or part [S 18].

A settlement arrived at in the course of a conciliation proceeding is *binding* for such period *as is agreed upon* by the parties. If no such period is agreed upon the settlement is binding for six months from the date on which the memorandum of settlement is signed by the parties to the dispute and will continue to be binding until the expiry of two months from the date on which a notice in writing is given by a party to the settlement to the other party or parties of an intention to terminate the settlement. In case of an award it is binding and shall come into operation on the expiry of 30 days from the date of its publication under section 17 and will remain in operation for a period of one year from the date on which the award becomes enforceable under section 17A. The appropriate Government can reduce the period or before the expiry of such period extend the period of operation or by any period not exceeding one year at a time as it thinks fit. However, the total period of any award cannot be made to exceed three years from the date on which

it came into operation. Where the appropriate Government, whether of its own motion or on the application of any part bound by the award, considers that there has been a material change in the circumstances on which the award was based it may refer the award or part of it to the Labour Court, National Tribunal or Tribunal as the case may be for decision whether the period of operation should be shortened by reason of such change, and such decision will be final [S. 19].

Prohibition of Strikes and Lock-outs

From the definitions given above it will be noticed that the term "*strike*" applies to a refusal or cessation of work by employees whereas the term "*lock-out*" applies to an employer preventing the employees from working. In both these cases the position at law is more or less similar as the *Act prohibits strikes and lock-outs in public utility service*. unless a notice of such strike or lock-out has been given within six weeks before the strike or lock-out. At least fourteen days must expire from the giving of such notice and the strike or lock out must not take place before the expiry of the date of strike or lock-out as mentioned in such notice. The Act also prohibits strikes and lock-outs during the pendency of conciliation proceedings before a Conciliation Officer or Board and seven days after the conclusion of such proceedings. A strike or lock out is also prohibited during the pendency of proceedings before a Labour Court, Tribunal or National Tribunal and two months after the conclusion of such proceedings as well as during any period in which a settlement or award is in operation in respect of any of the matters covered by the settlement or award [Ss. 22 & 23].

A strike or lock out commenced or declared in contravention of section 22 or 23 is termed "*illegal*". It would also be illegal where a reference has been made to a Board or Tribunal of an industrial dispute by the appropriate Government, and the strike or lock-out is continued in contravention of it by such Government prohibiting the continuance of any strike or lock-out in connection with such dispute, under section 10 (3). The Act also prohibits financial aid to illegal strikes and lock-outs [S. 25].

Chapter VI of the Act provides for *penalties* for illegal strikes and lock-outs and the penalties are (1) in case of a workman, imprisonment upto one month or fine upto Rs 50, or both; (2) in case of an employer, imprisonment extending to one month or fine upto Rs 1,000 or both. A person knowingly giving financial aid to illegal

strikes and lock-outs as well as any person who instigates or incites others to take part in or otherwise acts in furtherance of, an illegal strike or lock-out shall be punishable with imprisonment upto six months or fine upto Rs 1,000 or both [Ss. 26-28]. Penalties are also provided for breach of settlement or award, for disclosure of confidential information as well as for other offences [Ss. 20-31].

Protection of Persons Refusing to Take Part in Illegal Strikes or Lock-outs

The Act gives protection to persons who refuse to take part or to continue to take part in any illegal strike or lock-out. Such a person cannot by reason merely of such refusal be subject to expulsion from any Trade Union or society or to any fine or penalty or to deprivation of any kind or benefit which he, or his legal representatives would otherwise be entitled. Such a person cannot also be placed under any disability or disadvantage because of such conduct [S. 35].

Conditions of Service During Proceedings

During the pendency of proceedings before a Conciliation Officer, Board, Labour Court, Tribunal or National Tribunal in respect of an industrial dispute, the employer is not permitted to alter, to the prejudice of the workmen concerned in such dispute the conditions of service which were applicable to them before the commencement of such proceedings. The employer is also not permitted to discharge or punish, whether by dismissal or otherwise, any workman concerned in such dispute, the object being to maintain the *status quo*. If the employer wishes to do any of these things, he must obtain the express permission in writing of the authority before which the proceeding is pending. Where the employer contravenes these provisions, the employee aggrieved may make a complaint in writing to such Tribunal and the Tribunal will adjudicate upon the complaint as if it were a dispute referred to or pending before it [Ss. 33 & 33 A].

Lay-off and Retrenchment

The Act also provides for lay-off and retrenchment but these provisions do *not apply* to industrial establishments (1) in which less than 50 workmen on an average per working day have been employed in the preceding calendar month or (2) which are of a seasonal character or in which work is performed only intermittently [S. 25A].

A workman (other than a *badli* or a casual workman) whose name is on the muster rolls and has completed at least one year of continuous service under an employer if laid-off must be paid by the employer for the period of lay-off, (not including weekly holidays that may intervene) compensation equal to 50 per cent of the total of the basic wages and dearness allowance which would have been paid had he not been so laid off.

In during any period of 12 months, a workman is so laid-off for more than 45 days, no such compensation shall be payable in respect of any period of lay-off after the expiry of the first 45 days, if there is an agreement to that effect between the workman and the employer. [S 25] A *badli* workman means a workman employed in the place of another workman whose name is borne on the muster rolls and has not completed one year of continuous service in the establishment.

The workman is not entitled to compensation if he refuses to accept an alternative employment, or if he does not present himself for work at the appointed time at least once a day during normal working hours or where the laying-off is due to strike or slowing down of production in another part of the establishment [S. 25E]. A workman in continuous service for at least one year must not be retrenched, until he has been given one month's notice in writing mentioning the reasons for retrenchment and the period of notice has expired or has been paid wages in lieu of such notice. The workman must also be paid compensation equivalent to 15 days' average pay for every completed year of continuous service or any part thereof in excess of 6 months. Notice in the prescribed manner must also be served on the appropriate Government or such authority as may be specified by the appropriate Government by notification in the official Gazette, [S. 25F]. The Act also provides that the employer must ordinarily retrench the workman who was the last person to be employed in the category concerned [S. 25G] and such workman being a citizen of India must be given a preference in re-employment if he offers himself for such re employment when in future the employer proposes to employ any other workman. [S 25H] The 1957 amendment provides for notice and compensation to be paid by the employer in the case of a *transfer* by him of the undertaking—

- (1) to a workman who has been in continuous service for not less than one year in that undertaking immediately before such transfer,
- (2) if the service of the workman has been interrupted by the transfer,
- (3) if the terms and conditions of service after the transfer are less favourable.

- (4) if the new employer is not legally liable to pay in the event of the retrenchment of the worker, compensation on the basis that his service has been interrupted by the transfer [S. 25FF.]

Under section 25 FFA an employer intending to close down an undertaking shall be required to give a notice, in the prescribed manner, to the appropriate Government, at least 60 days before the date on which the intended closure is to become effective stating clearly the reasons thereof. Proviso to sub-section (1) of Section 25 FFA provides that this section shall not apply to—

(a) an undertaking in which—

- [i] less than fifty workmen are employed, or
- [ii] less than fifty workmen were employed on an average per working day in the preceding twelve months.

(b) an undertaking set up for the construction of buildings, bridges, roads, canals, dams or for other construction work or project.

Section 30A provides for the penalty for closure without notice, which shall be with imprisonment for a term extending to six months or with fine which may extend to five thousand rupees or with both.

Section 25FFF provides for compensation where the undertaking *closed down* for any reason but where it is due to unavoidable circumstances, not merely financial difficulties beyond the control of the employer the compensation must not exceed his average pay for three months [S. 25FFF].

Recent Changes in the Act in Regard to Lay-off, Retrenchment and Closure

The right of the employer in regard to lay-off, retrenchment and closure are now subject to restrictions in terms of the latest amendment to the Industrial Disputes Act, 1947. The restrictions apply to establishments employing three hundred or more workmen.

No workman in such an establishment shall be laid off except with the previous permission of the Government unless such lay-off is due to shortage of power or to natural calamity. If however the Government does not communicate grant of permission or refusal within two months from the date of such application, permission applied shall be deemed to have been granted on the expiration of the said period of two months.

In the case of retrenchment in such an establishment, no workman who has been in continuous service for not less than one year shall be retrenched unless he has been given three months' notice or payment of wages in lieu of such notice, compensation as for retrenchment has been paid and a notice in the prescribed form has been served on the Government and permission obtained. However, permission shall be deemed to have been granted on the expiry of two months from the date of application if no communication is received from the government within that period granting or refusing permission.

An employer intending to close down such an establishment shall give ninety days' notice to Government.

Penalty for contravention of the provisions in regard to lay-off and retrenchment may result in the imprisonment of the employer upto one month or a fine of rupees one thousand or both.

Human Relations in Industry

Human relations in industry aims at the development of a good relationship between the manager and the worker as an individual and as well as workers as a group which will foster understanding by each of the other's problems and needs. Creation of such an attitude in the subordinates will be of help to the manager in securing their co-operation in a more abundant measure which in turn will result in increased productivity for the organisation. It will also help to produce a sense of satisfaction in the subordinates. Mentally too the individual and the group will feel happy at the development of friendship with management.

Human relations are not something with which a manager is totally unacquainted. Without this approach it would be rather difficult for him to pull on as a manager. However, it is understood only in a very limited sense without appreciation of the implications of the expression. An outward gesture of warm friendliness to the worker by the manager and a tendency to concede his demands to the extent possible may initially create a good impression in the worker's mind but that will not have a long lasting effect because the worker soon or later will realise the hollowness of these actions of the manager.

In an industrial establishment, when a machine develops some trouble, it is the usual practice to examine it thoroughly to find out the root cause and rectify it. This is done for the reason that an unsafe machine will affect the production. However, when there is

some trouble with the behaviour of a worker, the management is inclined to ignore it. It is here that human relations in industry comes in and tells us that it is necessary here also to find out the reasons for the trouble and rectify it. Many times it is forgotten that a worker too is a human being and not a machine. He has his likes and dislikes and problems of his own. He would also like to be heard and his feelings respected. When an impression of importance is created in him, that makes the work he does, enjoyable for him. He then does that work better and the benefit goes to his organisation in the form of qualitative or quantitative production. It should not be forgotten that a worker also will have personal and family problems. Preoccupation of his mind in them will affect his efficiency at work. Personnel counselling at the supervisor's level even will make him happy. It is human psychology to feel relieved when there is someone to hear your problems. By talking to the supervisor about his problems at home, the worker feels a burden has been removed from his shoulders and attends to his work with a relieved feeling and he is his normal self at work. The effect is more felt if the supervisor has some solution for his problems or at least a word of consolation to say that things will improve soon.

Any person will feel happy if he is told that what occurred to him was a good idea and he should be rewarded for it. A suggestion scheme for the worker of an organisation will serve this purpose. It is one of the good ways of fostering human relations. It may also be that the suggestion of the worker will improve the functioning of the organisation. Latent talent in the worker would also be brought out by a thoughtful and well-planned suggestion scheme.

The next area for building up good human relations is to have a satisfactory grievance procedure and if this does not exist to evolve one. Justice must not only be done but must appear to be done. A confidence in the worker should be created that whenever things go wrong on account of some one's fault and he is affected, the wrong doer will be brought to book.

Having a promotion policy which aims at providing a reasonable chance for the worker to come up in the organisation will usher good human relations. To the same effect it will be allowing the worker participation in the management.

There are other areas also which will help to develop human relations in industry. All these relate to making the worker happy in body and spirit. However, it is necessary to strike a balance in

the giving of the facilities so that there is a wholesome growth of human relations.

Industrial Relations

There has been a tremendous growth of activity in the industrial sphere since independence. Growth in any area brings problems. Industrial growth in any area is no exception to the rule. Maintenance of good industrial relations not only helps to settle disputes between the two areas of conflict namely capital and labour but also assists in preventing further disputes coming into existence.

The reasons for dissatisfaction of the worker of an organization need not necessarily be economic. Adequate compensation in the form of money can certainly reduce the cause of friction between an employer and an employee to a large extent, yet financial reward alone for the worker's efforts will not satisfy him. Conditions of service relating to hours of work, nature of work, rules relating to work, attitude of the employer towards misconduct alleged against employees and other similar problems faced by a worker will have a bearing on the development of good industrial relations. In other words, human relations play a major role in shaping good industrial relations.

It is not possible for any employer to satisfy completely his worker on the monetary reward he receives for his work. This is an area where there will be constant discontent. However, by adopting a human approach to the worker's problems, good industrial relations can be built. It is rather very difficult to avoid completely disputes cropping up. It is however impossible to avoid such disputes taking a serious turn. Hence a well planned and implemented grievance procedure will assist in the building up of good industrial relations.

Settlement of Industrial Disputes

/The Industrial Disputes Act itself provides for prevention and settlement of industrial disputes by setting up a machinery for this purpose at various levels. Industrial adjudication may be negotiation at the home level, conciliation in the presence of a third party or statutory adjudication. Industrial establishments having 100 or more workers should have works committees where an equal representation to the employer and employee is provided. These committees are meant to prevent disputes arising at the factory level itself. Differences are tried to be settled by discussion between the two

interests and development of disputes attempted to be prevented at the home level at the meetings of the Works Committee.

The next stage is the attempt at settlement in the presence of a conciliation officer. These officers are appointed by the appropriate Government charged with the duty of mediating and promoting a settlement of industrial disputes. The function of a conciliation officer is merely to make efforts to bring about a settlement and report the result to the Government. In case he succeeds in bringing about a settlement, there is an end of the matter. In the event of failure, he is to report the matter to the Government and it is for the Government to decide whether the matter should be referred to a Labour Court or Tribunal.

Due to the spirit of settlement of an industrial dispute by negotiation at the home level or in the presence of a third person which is the object behind the enactment of the Industrial Disputes Act, statutory adjudication comes in only when the path of persuasion by the conciliation machinery does not yield the desired result. At the level of the Labour Court or Industrial Tribunal, both the sides of the dispute are discussed in a manner quicker than in ordinary civil courts and award given. A certain amount of finality is given to these awards in order that they may be implemented without undue delay caused by appeals being filed against them as in ordinary civil matters. Labour Courts under the Industrial Disputes Act are constituted for adjudication of industrial disputes relating to matters specified in the Second Schedule to the Act and for performing such other functions as may be assigned to them under the Act. The matters specified in the Second Schedule as being within the jurisdiction of the Labour Court are—

- (i) the propriety or legality of an order passed by an employer under the Standing Orders;
- (ii) the application and interpretation of the Standing Orders;
- (iii) discharge or dismissal of workmen including reinstatement of or grant of relief to the workman wrongly dismissed;
- (iv) withdrawal of any customary concession or privilege;
- (v) illegality of a strike or a lock-out; and
- (vi) All those matters other than those specified in the Third Schedule.

Industrial Tribunals on the other hand adjudicate on matters specified under the Second and Third Schedules. The Third Schedule enumerates the following matters namely—

- (i) wages including the mode of payment;
- (ii) compensatory and other allowances;
- (iii) hours of work and rest intervals;
- (iv) leave with wages and holidays;
- (v) bonus, profit sharing, Provident Fund and gratuity;
- (vi) shift working otherwise than in accordance with standing orders;
- (vii) classification by grades;
- (viii) rules of discipline;
- (ix) rationalization;
- (x) retrenchment of workmen and closure of the establishment and
- (xi) any matter that may be prescribed.

National Tribunals are constituted to adjudicate on disputes of national importance or when they are of such a nature that industrial establishments situated in more than one State are likely to be interested or affected by such a dispute.

Though the atmosphere for creation of good industrial relations exists today, there appears to be no substantial progress in that direction so far. The main reason for such a state of affairs is the entry of politics in the labour field. Unrest is caused not because the worker is really unhappy or discontented but there are certain elements who want to increase such discontentment from small frictions to achieve personal benefits by utilising such unrest. Since the working community is becoming enlightened of late, it is hoped that exploitation by selfish elements will cease and good industrial relations will bloom in the near future.

Domestic Enquiry

The Industrial Employment (Standing Orders) Act 1946 contains a list of acts and omissions which constitute misconduct. The list is only illustrative and not exhaustive. In the general sense, any conduct which is inconsistent with the trust and faith expected of any employee will be misconduct. When an employee is alleged to have committed such an act of misconduct, he throws himself open for disciplinary action. Such an action commences with the issue of a charge sheet. The charges levelled should be specific. An explanation for the charges should be called for from the employee. If this is found to be unsatisfactory, then the employer should hold an enquiry.

Domestic enquiries are generally conducted by the officers of the employer or his lawyer. There is no objection to adopting this procedure so long as there is no violation of the principles of Natural Justice. In the absence of any bias attributable to a particular officer, holding of these enquiries by the officers of the employer have been held to be good.

Though there are no written rules for the holding of the enquiry, decisions of courts have evolved a procedure in respect of the conduct of such enquiries by the employers. There are certain essential formalities to be observed by an employer in the conduct of such an enquiry. These are as follows:

- (i) The accused worker must be allowed to remain throughout the proceedings and examination of oral and documentary evidence should be done in his presence.
- (ii) The accused worker should be allowed to cross-examine witnesses deposing against him and also to examine witnesses of his own.
- (iii) In the event of the accused worker refusing to cross-examine any witness deposing against him or examine his own witnesses, this fact should be noted in the enquiry proceedings.
- (iv) The enquiry should start by requiring the management to adduce oral and documentary evidence on which they depend to substantiate their charge. The accused worker should then be asked to cross-examine these witnesses; to examine his own witnesses and to produce documentary evidence, if any, on which he relies. The recording of his statement and cross-examination of him by the management representative should be kept to the last.
- (v) The witnesses examined should be asked to sign at the foot of every page in respect of their depositions and answers in cross-examination.
- (vi) The accused worker should sign at the foot of all pages of the proceedings.
- (vii) It is desirable to record the depositions made on either side in the form of questions and answers. There is of course no prohibition for adopting the narrative form of recording as in court proceedings.
- (viii) Though not obligatory, it is advisable that the worker should be allowed to be assisted or represented by a co-

worker of his choice or by a representative from the Union to which he belongs.

- (ix) Requests for adjournment of the enquiry on reasonable grounds from either side should be allowed. The adjourned date, place and time should then be recorded by the Enquiry Officer and signatures of the parties [obtained thereunder.

After conclusion of the proceedings, the Enquiry Officer has to study the materials placed before him and come to a conclusion as to whether the accused is guilty or not of the alleged misconduct. This conclusion is called the Finding. Based on the Finding and taking into account the previous history of the accused worker, the punishment to be awarded to him is decided by the management.

QUESTIONS

1. Describe briefly the existing machinery for the prevention and settlement of industrial disputes.

2. Write the provisions of the Industrial Disputes Act relating to the following:

- (a) Commencement of the award.
- (b) Persons on whom settlements and awards are binding.
- (c) Period of operation of settlements and awards.

3. State whether compensation is payable to workmen in case of transfer and closing down of undertakings. Write the provisions, in this connection, according to the Industrial Disputes Act.

4. (a) When is a strike or lock-out illegal under the Industrial Disputes Act?

(b) As a result of faction between rival trade unions there was a stoppage of work for 12 days in a factory, and not a single worker out of a total strength of 2,200 men attended. The employer contended that the cessation of work was a 'concerted refusal' to work without notice and amounted to an illegal strike. Decide.

5. Define "industry" under the Industrial Disputes Act and discuss the main attributes of an industry giving illustrations.

6. Discuss fully the powers and obligations of the appropriate government in referring an industrial dispute for adjudication under the Industrial Disputes Act.

7. What is "lay-off"? Discuss the rights and obligations of a workman and an employer during a period of lay off?

8. What is an "Industrial dispute" under the Industrial Disputes Act? Can an individual dispute be an industrial dispute?

9. P, employed in the technical post of a pilot in an airline and getting a monthly remuneration of Rs 3,500/- claims that he is a 'workman' under the Industrial Disputes Act. Is the claim justified?

10. An Industrial dispute has arisen between an employer and his workmen numbering 90 in respect of matter specified in the Third Schedule of the Industrial Disputes Act. The dispute is referred to the Labour Court for adjudication. Is the reference valid?

11. A settlement is arrived at in the course of conciliation proceedings between an employer and some of his workmen represented by a union *AU* regarding wage scale. The settlement is to be in operation for one year. Before the expiry of one year, workmen belonging to a rival union *RU* raise an industrial dispute regarding wages scale contending that they were not parties to the settlement and the settlement was not binding on them. Examine the validity of this contention.

12. The services of a workman who has put in 10 years of continuous services are terminated on the ground that they are surplus to the requirement of the employer. What amount, if any, is the workman entitled to?

13. During the pendency of proceedings before a Labour Court, an employer wants to discharge a protected workman. Advise the employer on the procedure to be followed?

14. Fully explain the definition of "workman" under the Industrial Disputes Act.

15. What are the exceptions to the rule that an individual dispute cannot be an industrial dispute?

16. Section 10 of the Act confers a power rather than imposes a duty on the appropriate Government in the matter of references of disputes. Discuss.

17. Describe fully the provisions relating to voluntary reference of disputes under the Industrial Disputes Act?

18. Describe the extent of the liability, of an employer for compensation on account of closure under the Industrial Disputes Act?

19. Analyse in detail the definition of "industry" under the Industrial Disputes Act giving illustrations.

20. The University of *D* is engaged in imparting education to a large number of students. For this purpose it employs professors and other teaching staff; it also employs other manual workmen such as sweepers, office boys, drivers etc. The University is provided with capital from various sources for its expenses. Is the University an industry?

21. What is an award? Explain the provisions relating to the commencement and period of operation of an award under the Industrial Disputes Act.

22. Explain fully the concept of "retrenchment". What is the procedure to be followed by an employer while retrenching a workman?

23. Discuss the restraints imposed by the Industrial Disputes Act upon the power of an employer to terminate the services of a workman during the pendency of proceedings before a Labour Court?

24. What do you understand by "domestic enquiry"? What precautions would you take in conducting it?

25. What do you understand by the concept of "Human Relations in Industry".

26. Write a short note on "Industrial Relations".

Chapter 31

BOMBAY INDUSTRIAL RELATIONS ACT, 1946

ACCORDING TO THE objects and reasons of the *Bombay Industrial Disputes Act*, 1938, the *All India Trade Disputes Act* of 1929 which provided for the appointment of courts of enquiry and boards of conciliation had failed in certain particulars. The procedure, it was argued in connection with the appointment of these bodies was found to be so cumbrous and inconclusive in character that the Act had been rarely used in India during the nine years it had been on the Statute books. They pointed out that the Government of Bombay in 1934 passed the *Bombay Trade Disputes Conciliation Act* providing for the appointment of a labour officer whose chief duties were to secure redress of the grievances of the work people employed in the textile industry in Bombay city and for the appointment of the Commissioner of Labour as the Chief Conciliator to bring the two parties to the trade dispute in this industry together, with a view to their reaching an amicable settlement of the dispute. It was thus thought possible to extend the provisions of the Act so as to cover the textile industry in other centres or to cover other trades and industries in different centres but there was nothing in that Act making it obligatory to parties to a trade dispute to endeavour to obtain a settlement of it by conciliation before resorting to a strike for lock-out. Thus the object of the *Bombay Act* of 1938, according

to the Government of Bombay, was to ensure that this was done. It was pointed out that most countries of the world have comprehensive schemes of legislation aiming at peaceful settlement of all disputes between the employer and the employee and the provision for prevention of conflict which results in considerable financial losses not only to the employers and to the employee, but also to the community at large. According to the same authority the world legislation on this subject varies widely in character, scope and ranges from simple conciliation, either by private arrangement or through prominent conciliators appointed by the State, to compulsory acceptance by both parties of decisions or awards given by industrial arbitration tribunals or by industrial courts.

The Bombay industrial Disputes Act, 1938 provided an elaborate machinery for the settlement of industrial disputes in a peaceful and amicable manner and there were provisions to prevent victimisation of workers by the employer for legitimate activities in connection with trade unions. Provisions were made regarding compulsory standing orders, and prohibition of changes in such orders without the previous sanction of the Commissioner of Labour. The 1938 Act was amended from time to time and was eventually repealed and replaced by the Bombay Industrial Relations Act of 1946 which received the assent of the Governor General in April 1947.

The Bombay industrial Relations Act of 1946 is a very comprehensive piece of legislation. Various Provinces in India have adopted laws regarding trade disputes to supplement the Central Act, namely the Industrial Disputes Act of 1947 with which we have just dealt at some length. The Act passed in the Bombay State, however, is the most comprehensive. This Act makes it possible for industrial disputes to be disposed of more speedily and efficiently. It also gives a great impetus to labour to organise itself.

The principal object of the Act is to encourage collective bargaining and to maintain industrial peace by resorting to the machinery set up under the Act, to prevent illegal strikes and lock-outs and to provide lay-off and retrenchment compensation.

The Act applies to the whole of the State of Maharashtra and to such industries as are notified from time to time, by the Government of Maharashtra in exercise of the powers conferred on it by paragraph (ii) of clause (19) of section 3 and sub-section (4) of Section 2 of the Act, like Cotton Textile Industry, Silk Textile Industry. Woollen Textile Industry, Hosiery Industry, Textile Processing

Industry, Industry engaged in the generation and supply of electrical energy, Industry engaged in the conduct and maintenance of public passenger transport services by omnibus or tram and supply of electric energy, Sugar Industry, Banking Industry, etc.

Definitions

“Employee” means any person employed to do any skilled or unskilled work for hire or reward in any industry, and includes—

- (a) a person employed by a contractor to do any for him in the execution of a contract with an employer within the meaning of sub-clause (e) of clause (14);
- (b) a person who has been dismissed, discharged or retrenched, or whose services have been terminated from employment on account of any dispute relating to change in respect of which a notice is given or an application made under section 42 whether before or after his dismissal, discharge retrenchment or, as the case may be, termination of employment;

but does not include—

- (i) a person employed primarily in a managerial, administrative, supervisory or technical capacity drawing basic pay (excluding allowances) exceeding five hundred and fifty rupees per month.
- (ii) any other person or class of persons employed in the same capacity as those specified in clause (i) above, irrespective of the amount of the pay drawn by such persons which the State Government may, by notification in the official Gazette, specify in this behalf [S. 3 (13)].

“Employer” includes—

- (a) an association or a group of employers;
- (b) any agent of an employer;
- (c) where an industry is conducted or carried on by a department of the State Government, the authority prescribed in that behalf and where no such authority has been prescribed, the head of the department;
- (d) where an industry is conducted or carried on by or on behalf of a local authority, the chief executive officer of the authority;
- (e) where the owner of any undertaking in the course of or for the purpose of conducting the undertaking contracts with any person for the execution by or under the contractor of the whole or any part of any work which is ordinarily part of the undertaking, the owner of the undertaking [S. 3 (14)].

“Industrial Dispute” means any dispute or difference between an employer and an employee or between employers and employees and which is connected with any industrial matter [S. 3 (17)].

“Industrial matter” means any matter relating to employment, work, wages, hours of work-privileges, rights or duties of employers

or employees, or the mode, terms and conditions of employment, and includes—

- (a) all matters pertaining to the relationship between employers and employees, or to the dismissal or non-employment, of any person;
- (b) all matters pertaining to the demarcation of functions of any employees or classes of employees;
- (c) all matters pertaining, to any right or claim under or in respect of or concerning a registered agreement or a submission, settlement or award made under this Act;
- (d) all questions of what is fair and right in relation to any industrial matter having regard to the interest of the person immediately concerned and of the community as a whole [S. 3 (18)].

“*Industry*” means—

- (a) any business, trade, manufacture or undertaking or calling of employers;
- (b) any calling, service, employment, handicraft or industrial occupation or avocation of employees;

and includes—

- (i) agriculture and agricultural operations;
- (ii) any branch of an industry or group of industries which the State Government may, by notification in the official Gazette, declare to be an industry for the purposes of this Act [S. 3 (19)]

Registration of Unions

Chapter III of the Act deals with Registration of Unions. Under Section 12 the Registrar of Unions is required to maintain a Register of Unions and a list of “Approved Unions”. Unions are divided into three categories, viz. (1) “Representative” Unions, (2) “Qualified” Unions and (3) “Primary” Unions.

According to Sec. 13 (1) any union having a membership of more than 25 per cent of the total number of employees employed in any industry in any local area, during the whole of the period of three calendar months immediately preceding the calendar month in which it so applies, may apply in the prescribed form to the Registrar for registration as a “Representative” Union for such industry in such local area.

Section 13 (2) provides that if in any local area no Representative Union has been registered in respect of an industry, a union having a membership of not less than 5 per cent of the total number of employees employed in such industry during the whole of the period of three calendar months immediately preceding the month in which it

so applied, may apply in the prescribed form to the Registrar for registration as a "Qualified" Union for such industry in such local area.

Under sub-section (3) of S 13, where there is neither a Representative Union nor a Qualified Union, a union having a membership of not less than 15 per cent of the total number of employees employed in any undertaking in such industry and complying with the conditions specified in S.23, may apply in the prescribed form to the Registrar for registration as a "Primary" Union for such industry in such local area.

According to S.14, on receipt of an application for registration, on payment of prescribed fees, on satisfying the conditions requisite for registration specified in S.23 and the union is not otherwise disqualified for registration, the Registrar may enter the names of the Union in the appropriate register and issue a certificate of registration, subject to the following provisions—

- (1) There shall not be more than one registered union in the same industry.
- (2) The Registrar shall register a union fulfilling the conditions necessary for registration as a Representative Union in preference to one not fulfilling the said conditions and failing such a union fulfilling the conditions necessary for registration as a Qualified Union in preference to one not fulfilling such conditions.
- (3) Where two or more unions fulfil the conditions necessary for registration, the union having the largest membership of employees employed in the industry shall be registered.
- (4) The Registrar shall not register any union if the application is not made *bona fide* in the interest of the employees but is made in the interest of the employers to the prejudice of the interest of the employees.
- (5) The Registrar shall not register any union, if within six months immediately preceding the date of the application for registration the union has instigated, aided or assisted the commencement or continuation of a strike or stoppage which has been held or declared to be illegal.
- (6) The Registrar shall not register any union, if the rules of the union contain any provision debarring any employee in the industry concerned from being a member of such union on the ground that he is or is not an employee in any particular undertaking in the said industry.

Cancellation of Registration

A mandatory duty is cast on the Registrar to cancel registration of the union, if it incurs any of the disqualifications stated in S.15, which are as follows—

- (a) if there is a direction from the Industrial Court for cancellation of the registration of such union.
- (b) if after giving show cause notice and holding inquiry, the Registrar is satisfied—
 - (i) that it was registered under mistake, misrepresentation or fraud; or
 - (ii) that membership of the union has for a continuous period of three calendar months fallen below the minimum required under S 13 for its registration; or
 - (iii) that the registered union being a Primary Union has after registration failed to observe of the conditions specified in S 23; or
 - (iv) that the registered union is not being conducted *bona fide* in the interest of employees; or
 - (v) that it has instigated, aided or assisted the commencement or continuation of an illegal strike.
- (c) if its registration under the Indian Trade Unions Act, 1926, is cancelled.

Approved Unions

On an application made in the prescribed form, under S 23, the Registrar may after holding inquiry enter the union in such list, if he is satisfied that the union has made rules, that the provisions of the said rules are being duly observed by the unions, and the rules provide that—

- (i) its membership subscription shall be not less than fifty paise per month;
- (ii) its executive committee shall meet at intervals of not more than three months;
- (iii) all resolutions passed shall be recorded in a minute book kept for the purpose;
- (iv) accounts shall be annually audited by an auditor appointed by Government;
- (v) every industrial dispute in which a settlement is not reached by conciliation shall be offered to be submitted to arbitration and that arbitration shall not be referred by it in any dispute;
- (vi) no strike shall be sanctioned, resorted to, or supported by it unless all methods for settlement have been exhausted and the majority of its members vote by ballot in favour of such strike;
- (vii) no stoppage which is illegal shall be sanctioned by it;
- (viii) no 'go slow' shall be sanctioned, resorted to or supported by it.

Provided further that the Registrar shall not enter a union in the approved list, if he is satisfied that it is not being conducted *bona fide* in the interest of its members but to their prejudice.

Standing Orders

With a view to minimise the ground of conflict between the employers and workmen, the employers are required by law to frame standing orders and get them approved by appropriate authorities so that both the side abide by the standing orders and peaceful conditions prevail so far as the area covered by those orders is concerned. The standing orders are a sort of contracts between the parties and are amenable to modifications and alterations.

Under S. 35 every employer shall, within six weeks from the date of the application of this Act to an industry or within six months of starting of the undertaking as the case may be, submit for approval to the Commissioner of Labour in the prescribed manner draft standing orders regulating relations between him and his employees with regard to the industrial matters mentioned in schedule I. The Commissioner of Labour shall, after consulting representatives of employees, employers and such other interests concerned in the industry and making necessary inquiry, settle the said standing orders. A copy of the settled standing orders shall be forwarded to the Registrar who shall within 15 days record them in the register. Standing orders so settled shall come into operation from the date of their record in the register. Until standing orders come into force, model standing orders shall apply to such undertaking.

Changes

The employer as also the employee is required to give notice of every change intended by him. Under S. 3 (8) a "change" is defined as "alteration in industrial matter" and the term "industrial matter" is defined in S. 3 (18). Either there is a settlement between the parties on the proposed change or a dispute comes into existence, and in the latter case, conciliation or arbitration proceedings commence, unless the State Government intervenes earlier and refers the dispute for arbitration under Ss. 72 and 73. Every illegal change is punishable under the Act.

Changes in wages, withdrawal of dearness allowance, discontinuing the night shift, change in timings and reducing the strength of permanent posts are some of the instances of "changes", within

the meaning of S. 42 of the Act. Law requires that if any change in the *status quo* is desired the procedure prescribed should be followed.

An agreement of change arrived at between the parties has to be registered under S. 44 (1). If it is not registered, it is open to the Labour Court to consider whether there exists any ground to maintain it. But when an agreement was sent to the Registrar for registration, but through oversight the agreement was not registered, it would not be equitable to hold that the change brought about by the company in pursuance of the agreement and in anticipation of registration was invalid.

Section 46 deals with illegal changes, e.g. changes in standing orders without following the prescribed procedure, changes in the terms of registered agreements, settlements, awards, etc. Non-compliance with the terms of all these amounts to an illegal change. Where an award requires payment of additional dearness allowance by a certain date, paying it in instalments amounts to modification of the award and therefore, an illegal change.

The Act also provides for the establishment of a *Labour Court* as well as *Industrial Courts*. The Act was amended in 1958 with a view to settling up of *Wage Boards*. The Act also makes provision for the formation of Joint Committees and prohibits certain types of strikes and lock-outs as being illegal.

Illegal Strikes and Lock-outs

Section 97 of the Act indicates what would constitute an illegal strike. Section strikes are absolutely prohibited, e.g. those relating to any matter stated in Schedule III. All strikes are not *per se* illegal. Under S. 97 (1) (c) a strike is illegal if it is commenced or continued for the only reason that the employer has not carried out the provision of any standing order or has made an illegal change. The test is not whether there was a legal or illegal change.

Sections 97 and 98 do not prohibit strikes and lock-outs generally, but prohibit them during the pendency of conciliation proceedings or reference or during the period an award or settlement is in operation and covers matters in relation to which a strike or lock-out is resorted to. But a strike or lock-out in relation to matters outside the purview of the award or settlement would not be illegal.

Industrial Legislation in other States

As has been mentioned above, some of the States have passed their own law with regard to trade disputes to supplement the

Central Act. The Bombay legislation is the most exhaustive and comprehensive. Some of the other States have also adopted similar legislation, e.g., *The Industrial Disputes (Madras Amendment) Act, 1949*, was passed in June 1949. *The Central Provinces and Berar Industrial Disputes Settlement Act, 1947*, was passed in May 1947 and provides for a permanent conciliation machinery, made up of Conciliators, a Chief Conciliator for the State, Special Conciliators, Provincial and District Industrial Courts, etc. In the United Provinces, the *United Province Industrial Disputes Act, 1947*, makes provisions for prevention of strikes and lock-outs as well as for the settlement of industrial disputes.

QUESTIONS

1. Define "employee" under the Bombay Industrial Relations Act and show in what respects he differs from "workman" under the Industrial Disputes Act?
2. Describe fully the different types of registered unions under the Bombay Industrial Relations Act. Can two types of registered unions exist in the same industry in a local area?
3. Discuss the provisions under the Bombay Industrial Relations Act relating to notice of change to be given by an employer and by an employee.
4. What is submission under the Bombay Industrial Relations Act? Under what circumstances, if at all, can a submission be revoked?
5. What is a 'change' under the Bombay Industrial Relations Act? Describe the obligations of an employer before effecting a change?
6. Can the parties themselves refer an industrial dispute for arbitration to the Industrial Court? If so, when?
7. What is a Representative Union? Distinguish it from other types of unions under the Bombay Relations Act?
8. Describe the provisions under the Bombay Industrial Relations Act relating to appearance for employees?

THE INDUSTRIAL EMPLOYMENT (STANDING ORDERS) ACT, 1946

BEFORE 1946, THE CONDITIONS of employment were chaotic. In many industrial establishments, the terms of employment were not always uniform and, sometimes, were not reduced to writing, which led to considerable confusion which ultimately resulted in industrial disputes. The bargaining power of labour was weak due to age-old poverty, mass illiteracy, and ignorance. The unions were in a state of arrested growth due to many factors like social, economic and political. In order to remedy the situation the legislature passed the Act on 23rd April, 1946 and it came into force on 1st April, 1947. The Act seeks to bring about uniformity in terms and conditions of employment in industrial establishments and thereby to minimize industrial conflict.

Applicability of the Act

The Act makes it compulsory for employers engaging one hundred or more workmen to define with sufficient precision the conditions of employment and to make those conditions known to the workmen. The appropriate Government is empowered to extend the provisions of the Act, to any industrial establishment employ-

ing less than 100 workmen after giving two months' notice. The sub-section (4) of Section 1 provides that the Act shall not apply to any industry to which the provisions of chapter VII of the Bombay Industrial Relations Act of 1946 apply, or to any industrial establishment to which the provisions of the Madhya Pradesh Industrial Employment (Standing Orders) Act of 1961 apply; but notwithstanding the operation of the Madhya Pradesh Act, the provisions of this Act shall apply to all industrial establishments under the control of the Central Government.

Procedure for Certification of Standing Orders

Within six months from the date on which Act becomes applicable to an establishment, the employer has to present five copies of the draft Standing Orders to the certifying officer for certification. The draft should cover the matters enumerated in the schedule and should conform, so far as is practicable, to the model standing orders prescribed by the government.

The schedule to the Act provides for the following matters which are to be provided in standing orders.

1. Classification of workmen, e.g., whether permanent, temporary, apprentices, probationers or badlis.
2. Manner of intimating to workmen periods and hours of work, holidays, pay day and wage-rates.
3. Shift working.
4. Attendance and late-coming.
5. Conditions of procedure in applying for, and the authority which may grant, leave and holidays.
6. Requirements to enter premises by certain gates, and liability to search.
7. Closing and reopening of section of the industrial establishments and temporary stopping of work and the rights and liabilities of the employer and workmen arising therefrom.
8. Termination of employment, and the notice thereof to be given by employer and workmen.
9. Suspension or dismissal for misconduct, and acts or omissions which constitute misconduct. The rule 14 (3) provides that the following acts and omissions shall be treated as misconduct.
 - (a) Wilful insubordination or disobedience, whether alone or in combination with others, to any lawful and reasonable order of a superior.
 - (b) theft, fraud or dishonesty in connection with the employer's business or property;
 - (c) wilful damage to or loss of employers; goods or property;
 - (d) taking or giving bribes or any illegal gratification;

- (e) habitual absence without leave or absence without leave for more than 10 days;
 - (f) habitual late attendance;
 - (g) habitual breach of any law applicable to the establishment;
 - (h) riotous or disorderly behaviour during working hours at the establishment or any act subversive of discipline;
 - (i) habitual negligence or neglect of work;
 - (j) frequent repetition of any act or omission for which a fine may be imposed to a maximum of 2 per cent of the wages in a month;
 - (k) Striking work or inciting others to strike work in contravention of the provisions of any law, or rule having the force of law.
10. Means of redress for workmen against unfair treatment or wrongful exactions by the employer or his agents or servants.
11. Any other matter which may be prescribed.

The draft standing orders shall be accompanied by a statement giving prescribed particulars regarding the workmen employed and their unions. Even where the draft standing orders provides for matters set out in the schedule and is otherwise in conformity with the provisions of the Act, the certifying officer or the Appellate Authority as the case may be is entitled to adjudicate upon the fairness or reasonableness of the provisions made in the draft.

The certifying officer shall take a decision on the draft standing orders submitted by the employer after calling for objections, if any, of the workers or their union and after giving a hearing to both parties. He shall then pass a written orders on the matter. The certifying officer shall thereupon certify the Standing Orders with or without modifications, and forward authenticated copies thereof to the employer and to the trade union or other prescribed representatives of the workmen. An aggrieved party may appeal to the Appellate Authority within 30 days from the date on which copies of the Standing Orders are sent by certifying officer. The order of the Appellate authority shall be final.

The Standing Orders shall come into operation on the expiry of 30 days from the date on which authenticated copies thereof are sent by the certifying officer, and when an appeal has been filed, on the expiry of seven days, from the date on which copies of the order of the appellate authority are sent by him.

Period of Operation of Standing Orders

Except on agreement between the employer and the workmen, the certified Standing Orders shall not be liable to modification until the

expiry of six months from the date on which the Standing Orders or the last modification thereof came into operation. Any modification of the Standing Orders, whether at the instance of the employer or the workmen, will have to pass through the same procedure as in the case of the first certification.

There is no express provision in the Act restricting the right to apply for modification or the power of the authorities to allow modification except that six months must have elapsed since the certification of the last modification. Therefore it cannot be contended that a change in circumstances is a condition precedent to the maintainability, of an application without proof of such a change amounts to a review, by the same authority of its earlier order or certification.

Interpretation of Standing Orders

In the event of a dispute regarding the interpretation of the Standing Orders, the employer or the workmen may refer the question to any one of the Labour Courts authorised by the State Government to decide such questions, and such decision shall be fixed and binding on the parties.

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APPRENTICE ACT, 1961

THIS is a Central Act. The provisions of the Act shall not apply to; (i) any area or to any industry in any area unless the central government by notification in the official gazette specifies that area or industry as an area or industry to which the said provisions shall apply with effect from such date as may be mentioned in the notification; (ii) any graduate or diploma apprentice undergoing training in accordance with any scheme framed by or with the approval of the government; and (iii) any special apprenticeship scheme for imparting training to apprentices in non-designated trades. Designated trade means a trade which the central government after consultation with the central apprenticeship council may by notification in the official gazette specify as a designated trade for the purposes of this Act.

An apprentice is defined to mean a person who is undergoing apprenticeship training in a designated trade in pursuance of a contract of apprenticeship. He has to be not less than fourteen years of age and satisfy such standards of education and physical fitness as may be prescribed. The contract of apprenticeship has to be in consonance with the provisions of this Act and is to be registered with the apprenticeship adviser. An apprentice undergoing training shall have the following obligations fulfilled namely: (i) to learn this trade conscientiously and diligently and endeavour

to qualify himself as a skilled craftsman before the expiring of the period of training; (ii) to attend to practical and instructional classes regularly; (iii) to carry out the lawful orders of his employer and superiors in the establishment and (iv) to carry out his obligations under the contract of apprenticeship. He shall be paid during the period of training such stipend at a rate not less than the prescribed minimum rate as may be specified in the contract of apprenticeship and the stipend so specified shall be paid at such intervals and subject to such conditions as may be prescribed. Further an apprentice shall not receive any other payment from his employer nor shall be paid on the basis of piece work or required to take part in any output bonus or other incentive bonus scheme. Provisions relating to health, safety and welfare as contained in the Factories Act are made applicable to him and he is made entitled to such leave as may be prescribed in this connection and to such holidays as are observed in the establishment in which he is undergoing training. In respect of personal injury caused to him by accident arising out of and in the course of training as an apprentice the employer shall be liable to pay him compensation which shall be determined and paid so far as may be in accordance with the provisions of the Workmen's Compensation Act subject to such modifications as are specified in the schedule to this Act. Except as provided expressly in the Act, an apprentice undergoing training in a designated trade in an establishment shall be a trainee and not a worker and the provisions of any law with respect to labour shall not apply to him or in relation to him.

An employer under the Act has an obligation to provide the apprentice training in his trade in accordance with the provisions of the Act either by himself if he is qualified in the trade or through a qualified person. He shall also carry out his other obligations under the contract of apprenticeship. Different periods of training are fixed for apprentices who have undergone institutional training in a school or other institutions recognised by the National Council and passed the prescribed tests and other apprenticeship. The number of apprentices for a designated trade in proportion to the number of workers is decided by the National Council which is only the minimum. Apprentices completing the training shall have to appear for a test on passing which they shall be awarded a certificate by the National Council which conducts such a test. It shall not be obligatory on the part of the employer to offer employment

to any apprentice who has completed the period of his apprenticeship training in his establishment and there is no obligation on the part of the apprentice to accept an employment under the employer.

In addition to the government, the Act has set up the following authorities: (i) The National Council; (ii) The Central Apprenticeship Council; (iii) The Central Apprenticeship Adviser; (iv) The State Apprenticeship Council; and (v) The State Apprenticeship Adviser. The functions of these authorities shall be as may be designated to them by the government and in the case of the state council they shall also perform such functions as may be designated to them by the Central Council.

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Chapter 34

TRADE UNIONS ACT, 1926

Origin of Trade Unions

THE EARLY CONFLICTS between capital and labour in Europe and in America resulted in labour organising itself into associations and unions for self-protection and self-help. Separate unions were formed for different industries and although their earlier years were full of bitter struggles with the employer as well as with the obstacles placed against them by the law, today they are recognised by law and occupy a dignified place in the industrial world, full of power and influence.

Advantages & Disadvantages of Trade Unions

The following are briefly *the advantages* of the unions—

- (1) Trade Unions help to keep wages at a uniform level according to the actual economic value.
- (2) Trade Unions enforce a spirit of self-reliance and self-respect among workmen thus contributing their share to the building up of national character.
- (3) Being members of an organised body, workmen are able to negotiate with their employers and place their grievances with a certain status and dignity.

- (4) Being organised bodies, Trade Unions can get the best professional assistance and are thus able to meet employers on an equal footing.
- (5) In advanced countries Trade Unions have laid down a standard of efficiency and experience as a condition precedent to full membership and thus given the employer better workmen.
- (6) Trade Unions in advance countries have raised the standard of living among workmen.
- (7) The growing power and influence of Trade Unions has brought into existence conciliation and arbitration boards composed of representatives of both capital and labour. This has resulted in a better understanding of each other's problems.

This advantages arise mainly through the misuse of the power of combination which these Trade Unions possess, sometimes a strike in one basic industry, e.g., coal or electricity, paralysing production in all other industries which depend on the supply of the striking industry for fuel, power, raw material etc. Trade Unions also indirectly force the employer to engage a large number of workmen than is necessary by Trade Union rules which prevent a superior workman from undertaking a particular job without the help of a certain number of junior assistants. On the whole, however, Trade Unions are doing good work in bringing about a better understanding between capital and labour.

The Trade Unions Act, 1926 was passed to provide for the registration of Trade Unions and in certain respects to define the law relating to registered Trade Unions.

Definition

A "trade union" is defined by the Act as meaning, any combination, whether temporary or permanent, formed, primarily for the purpose of regulating the relations between workmen and employers or between workmen and workmen, or between employers and employers, or for imposing restrictive conditions on the conduct of any trade or business, and includes any federation of two or more trade unions [S. 2(b)].

"Trade dispute" means any dispute between employers and workmen, or between workmen and workmen, or between employ-

ers and employers, which is connected with the employment or non-employment, or the terms of employment or the conditions of labour, of any person, and "*workmen*" means all persons employed in trade or industry whether or not in the employment of the employer with whom the trade dispute arises. [S. 2(g)].

Registration

Any seven or more members of a trade union may subscribe their names to the rules of the trade union and otherwise complying with the provisions of the above Act apply for registration under the Act to the Registrar of Trade Unions appointed by the appropriate Government for the State [Ss. 3 & 4]. The application must be accompanied by a copy of the rules of the trade union and a statement of the following particulars namely—

- (1) the names occupations and addresses of the members making the application;
- (2) the name of the Trade Union and the address of its head office; and
- (3) the titles, names, ages, addresses and occupations of the officers of the Trade Union [S. 5].

A Trade Union will not be entitled to registration unless its executive is constituted according to the provisions of the Act and the rules of the union provided for the following matters—

- (1) the name of the Trade Union;
- (2) the whole of the objects for which the Trade Union has been established;
- (3) the whole of the purposes for which the general funds of the Trade Union shall be applicable, all of which purposes shall be purposes to which such funds are carefully applicable under this Act;
- (4) the maintenance of a list of the members of the Trade Union and adequate facilities for the inspection thereof by the office-bearers and members of the Trade Union;
- (5) the admission of ordinary members who shall be persons actually engaged or employed in any industry with which the Trade Union is connected, and also the admission of the number of honorary or temporary members as office-bearers required under section 22 to form the executive of the Trade Union;
- (6) the payment of a subscription by members of the Trade Union which shall be not less than twenty-five naya paise per month per member;
- (7) the conditions under which any member shall be entitled to any benefit assured by the rules and under which any fine or forfeiture may be imposed on the members;
- (8) the manner in which the rules shall be amended, varied or rescinded;
- (9) the manner in which the members of the executive and the other office-bearers of the Trade union shall be appointed and removed;

(10) the safe custody of the funds of the Trade Union, an annual audit in such manner as may be prescribed, of the accounts thereof, and adequate facilities for the inspection of the account books by the office-bearers and members of the Trade Union; and

(11) the manner in which the Trade Union may be dissolved.

The precaution to be taken here is that the *name* under which the union seeks to be registered is *not identical with that of any other existing registered Trade Union*. The Registrar can also refuse to register the name if, in his opinion, the name so *nearly resembles* that of an existing registered Trade Union as to be likely to deceive the public or the members of either Trade Union [S. 7]. On registration the Registrar issues a *certificate of registration* in the prescribed form which is *conclusive evidence* of the fact that the said Trade Union has been duly registered [S. 9].

The Registrar, of course, has the right to withdraw or *cancel* this certificate either on the *application of the Trade Union* itself or where the *Registrar is satisfied* that the certificate has been obtained by fraud or mistake or that the said Trade Union has ceased to exist or after receiving notice from the Registrar it wilfully contravened any provision of this Act; the same would be the case if the union had allowed any rule to continue in force which is inconsistent with any such provision of the Act or has rescinded any rule provided for any matter, provision for which is required by section 6. The Registrar must give not less than two months' previous notice in writing to the Trade Union (except where application was made by the Trade Union itself) giving the ground on which it is proposed to withdraw or cancel the certificate [S. 10].

All communications and notices to a registered Trade Union may be addressed to its registered office. Notice of any change in the address of the head office must be given to the Registrar within fourteen days [S. 12]. Every registered Trade Union is a *corporate* with a perpetual succession and a common seal with power to acquire and hold property, both moveable and immovable, to enter into contracts and to sue and be sued in its corporate name [S.13].

Appeals

The person *aggrieved by any refusal of the Registrar to register a Trade Union or by withdrawal or cancellation of a certificate of registration* can *appeal* to the proper authorities. Where the head office of the Trade Union is situated within the limits of a Presidency town, the appeal must be made to the High Court and where such office is situated in any other area to a Court as appointed by

the appropriate Government which Court shall not be inferior to the Court of an additional or assistant Judge of a principal Civil Court of original jurisdiction [S. 11].

The party aggrieved either through the withdrawal or cancellation of certificate has a right to appeal within the prescribed period to such judge not below the grade of an additional or assistant judge of a principal civil court of original jurisdiction as the local Government may appoint in this matter.

The Societies Registration Act, 1860, Co-operative Societies Act, 1912, and the Companies Act, 1956, do not apply to any Trade Union, and the registration of any such Trade Union under any such Act will be void [S. 14].

Funds of Trade Union

The funds of a registered trade union cannot be spent on objects other than those laid down by the Act such as—

(1) Payment of salaries, allowances and expenses to its office-bearers;

(2) Payment of expenses for its administration including audit of accounts;

(3) for prosecuting or defending a legal action to which the union or any of its members is a party, when such prosecution or defence is undertaken for the purpose of securing or protection any rights of the union or any rights arising out of the relations of any member with his employer or with a person whom the member employs;

(4) the conduct of trade disputes on behalf of the trade union or any member thereof;

(5) the compensation of members for loss arising out of trade disputes;

(6) allowances to members or their dependents on account of death, old age, sickness, accidents or unemployment of such members;

(7) the issue of, or the undertaking of liabilities under, policies of assurance on the lives of members, or under policies insuring members against sickness, accident or unemployment;

(8) the provision of educational, social or religious benefits for members (including the payment of the expenses of funeral or religious ceremonies for deceased members) or for the dependents of members;

(9) the upkeep of a periodical published mainly for the purpose of discussing questions affecting employers or workmen as such;

(10) the payment, in furtherance of any of the objects on which the general funds of the Trade Union may be spent, of contributions to any cause intended to benefit workmen in general, provided that the expenditure in respect of such contributions in any financial year shall not at any time, during that year, be in excess of one-fourth of the combined total of the gross income which has up to that time accrued to the general funds of the Trade Union during that year and of the balance at the credit of those funds at the commencement of that year;

(11) subject to any conditions contained in the notification, any other object notified by the appropriate Government in the official Gazette [S. 15].

Constitution of Separate Fund for Political Purposes

A registered trade union is permitted by the Act to constitute a separate fund from contributions separately levied for such funds and out of this fund payments may be made for the promotion of civic and political interests of its members in furtherance of the following objects—

(1) the payment of any expenses incurred, either directly or indirectly, by a candidate or prospective candidate for election as a member of any legislative body constituted under the Government of India Act or the Constitution or of any local authority, before, during, or after the election in connection with his candidature or election; or

(2) the holding of any meeting or the distribution of any literature or document in support of any such candidate or prospective candidate; or

(3) the maintenance of any person who is a member of any legislative body constituted under the Constitution or of any local authority; or

(4) the registration of electors or the selection of a candidate for any legislative body constituted under the Constitution or for any local authority; or

(5) the holding of political meetings of any kind, or the distribution of political literature or political documents of any kind.

The above is subject to the condition that no member of the Union can be compelled to contribute to the above fund for political pur-

poses and that the Union will not have the right to exclude such member from the benefit of the Union or to inflict any disability by reason of such non-payment. Neither has the Union a right to make such contribution for political purposes a condition precedent for admission to its membership [S. 16].

Books of Trade Union

The *books of accounts* of a registered trade union and its list of members shall be open to inspection by any office-bearer or member of the trade union at such times as may be provided for in the rules of the Trade Union [S. 20].

Annual Returns

Every registered Trade Union is required by section 28 to send annually to the Registrar on or before a prescribed date a general *audited statement of all receipts and expenditure* during the year ending 31st day of December next preceding such prescribed date, and of the *assets and liabilities* existing on such 31st day of December. This general statement must be accompanied by a *statement* showing all changes of *office-bearers* made by the Trade Union during the year, together with a *copy of the rules* of the Trade Union corrected up to the date of despatch. A copy of every alteration in the rules is also required to be made to the Registrar within fifteen days of the making of the alteration. Failure to submit any notice, statement or other document as required by the Act is punishable with fine. [S. 31].

Immunity from Criminal and Civil Liability

The Act provides that no office-bearer or member of a Registered Trade Union will be liable to punishment under section 120B (2) of the Indian Penal Code in respect of any agreement made between the members unless the agreement is an agreement to commit an offence [S. 17]. Immunity is also provided by section 18 from civil suits in respect of any act done in contemplation or furtherance of a trade dispute to which a member of the Trade Union is a party on the ground only that such act induces some other person to break a contract of employment, or, that it is in interference with the trade business or employment of some other person or with the right of some other person to dispose of his capital or of his labour as he wills. A registered Trade Union is also immune from any civil action in respect of a tortuous act done in contemplation or furtherance of a trade dispute by an agent of the Trade Union, if it proved that such person acted without the knowledge of, or cont-

rary to express instructions given by, the executive of the Trade Union [S. 18 (2)].

Agreements in Restraint of Trade

An agreement between the members of a Registered Trade Union cannot be avoided on the ground that any of its objects is in restraint of trade but this will not mean that civil action can be entertained for enforcing or recovering damages of the breach of any agreement concerning the conditions on which any members of a Trade Union shall or shall not sell their goods, transact business, work, employ or be employed [S. 109].

Amalgamation of Trade Unions

Provision is made for amalgamation of any two or more registered Trade Unions with or without dissolution or division of funds provided the votes of at least one half of the members each of such Trade Unions are recorded and at least sixty per cent of the votes are in favour of the proposal [S. 24]. Notice of such amalgamation is required to be given to the Registrar as provided in section 25.

Minors as Members

A person who has *attained the age of fifteen years* may be a member of a registered Trade Union, subject to any rules of the Trade Union to the contrary, and may if the Union rules permit enjoy all the rights of a member.

Disqualifications of Office-Bearers

A person is disqualified for being chosen as, and for being, a member of the executive or any other office-bearer of a registered Trade Union if he has—

- (a) not attained the age of eighteen years;
- (b) been convicted by the Court in India of any offence involving moral turpitude and sentenced to imprisonment, unless a period of five years has elapsed since his release.

A person convicted as mentioned in (b) above, before the commencement of the Indian Trade Unions (Amendment) Act 1964, shall also cease to be such member or office-bearer on the date of such commencement unless a period of five years has elapsed since his release before that date [S. 21-A].

Proportion of Officers to be connected with the Industry

At least half the total number of officers of every registered Trade Union must be persons actually engaged or employed in an industry with which the Trade Union is connected unless the appropriate Government by order exempts a particular Trade Union or a class of Trade Unions from this provision [S. 22].

Change of Name

The consent of two-thirds of the total number of members is necessary for the change of the name of a registered trade union [S. 23]. Notice of such change must be given to the Registrar in the manner prescribed by section 25.

Dissolution

When a registered Trade Union is dissolved *notice* of such dissolution signed by seven members and the secretary must *within fourteen days of such dissolution be sent to the Registrar*. The Registrar has to see that the said dissolution has been effected in accordance with the rules of the Union. If the rules do not provide for the distribution of funds on dissolution, the Registrar is given the power by the Act to divide the funds amongst the members of the Union in such manner as may be prescribed [S. 27].

Power of Industrial Court to Decide Certain Disputes

In February 1969, the State Government of Maharashtra inserted a new section, S. 28 (1-A) by Maharashtra Act No. III of 1969. Under this section, where there is a dispute regarding—

(a) whether or not any person is an office-bearer or member of a registered trade union including any dispute relating to wrongful exculsion of any such office-bearer or member; or

(b) the property (including the account books) of any registered Trade Union; in such a case any member or such registered Trade Union within six months may, with the prior consent of the Registrar and in prescribed manner, refer the dispute to the Industrial Court constituted under the Bombay Industrial Relations Act, 1946, for decision.

Sub section (2) provides that the Industrial Court shall, after hearing the parties to the dispute, decide the dispute, and may require an office-bearer or member of the registered Trade Union to be appointed, whether by election or otherwise, under the super-

vision of such person as the Industrial Court may appoint in his behalf, or removed in accordance with the rules of the Trade Union. It is further provided that the Industrial Court may, pending the decision of the dispute, make an interim order specifying or appointing any person or appointing a committee of administration for any purpose under the Act including the purpose of taking possession or control of the property in dispute and managing it for the union pending the decision.

According to sub section (3), the decision of the Industrial Court shall be final and binding on the parties, and shall not be called in question in any civil court.

Sub-section (4) provides that no civil court shall entertain any suit or other proceeding in relation to the dispute referred to the Industrial Court aforesaid, and if any suit or proceeding is pending in any such court, the civil court shall, on receipt of an intimation from the Industrial Court that it is seized of the question, cease to exercise jurisdiction in respect thereof.

Finally, sub-section (5) provides that in deciding disputes under this section, the Industrial Court may exercise the same powers and follow the same procedure as it exercises or follows for the purpose of deciding industrial disputes under the Bombay Industrial Relations Act, 1946.

QUESTIONS

1. State what advantages a Trade Union and its members enjoy on registration of the union under the Indian Trade Unions Act.
2. Define the terms "Trade Union" and "Trade Dispute"?
3. What is the procedure for the recognition of a Trade Unions? What constitutes unfair practices by employees and Unions under the Trade Unions Act.
4. (a) Can a registered Trade Union spend any of its general funds for political purposes? Can it constitute a separate fund for political purposes? What is the effect of refusal on the part of a member to contribute to a political fund?

(b) State the disqualifications of the office-bearers of Trade Unions.
5. Describe the procedure for the registration of a Trade Union and its dissolution.

Chapter 35

THE PAYMENT OF WAGES ACT, 1936

THIS ACT WAS passed with the *primary object* of remedying grievances with regard to delays which occurred in the payment of wages to persons employed in industry and also against the practice of imposing fines upon these workmen. The matter was investigated and the material collected placed before the Royal Commission on Labour appointed in the year 1929. The Commission's Report published in 1938 was thereafter embodied in a Bill which was circulated for eliciting public opinion and thereafter passed through the legislature. According to some writers this is almost the first legislation of its kind in India though in England a similar legislation known as "The Truck Acts", 1831, 1887 and 1896, do exist as well as the Employers and Workmen Act, 1875 and Hosiery Manufacture (Wages) Act, 1874 and Factory and Workshops Act 1901. There was an important amendment Act in 1951. The Act extends to the whole of India except the state of Jammu and Kashmir. It applies in the first instance to the payment of wages to persons employed in any factory and to persons employed (otherwise than in a factory) upon any railway administration or either directly through a sub-contractor, by a person fulfilling a contract with a

railway administration. This Act will not apply to wages payable in respect of a wage-period which, over such wage-period, average Rs 1,000 a month or more. Thus employees getting Rs 1,000 or more, do not fall under this Act [S. 1].

What are Factories and Industries Establishments?

“*Factory*” under this Act has the same meaning as the definition of a factory in section 2 (m) of the Factories Act of 1948.

An “*industrial establishment*” is defined by Section 2 (ii) to mean any—

- (a) tramway service, or motor transport service engaged in carrying passengers or goods or both by road for hire or reward;
- (b) air transport service other than such service belonging to, or exclusively employed in the military, naval or air forces of the Union of the Civil Aviation Department of the Government of India;
- (c) dock, wharf or jetty;
- (d) inland vessel, mechanically propelled;
- (e) mine, quarry or oil-field;
- (f) plantation;
- (g) workshops or other establishment in which articles are produced adapted or manufactured, with a view to their use, transport or sale;
- (h) establishment in which any work relating to the construction development of maintenance of buildings, roads bridges or canals, or relating to operations connected with navigation, irrigation or the supply of water, or relating to the generation, transmission and distribution of electricity or any other form of power is being carried on.

What are Wages?

“*Wages*” mean all remuneration which can be expressed in terms of money including (a) remuneration payable under an award or settlement, (b) for overtime holidays or leave, (c) bonus or additional remuneration whether called a bonus or by any other name, (d) payment due by termination of employment where no time for payment is provided, (e) payment under any scheme framed by the law but does not include (1) value of house-accommodation, or supply of light, water, medical attendance etc., (2) employer's contribution to pension fund or provident fund, (3) travelling allowance, (4) allowance for special expenses, (5) gratuity payable on discharge, and (6) bonus (whether under a scheme of profit sharing or otherwise) not forming part of remuneration under terms or employment or award or settlement or order of a court [S. 2 (vi)].

It was held that the term wages, as defined above, does not include compensation payable for lay-off under the *Industrial Disputes Act, 1947* and that the contract of employment is not brought to an end by a lay-off. It was held in the same case that what is contemplated by section 2 (vi) (e) (refer to above definition of wages) is a payment under some scheme like the Provident Fund Scheme and that it does not apply to any sum payable under the provisions of the Payment of Wages Act.¹

Responsibility for Payment of Wages

The responsibility for the payment of wages, as required by this Act, will rest on every employer and in case there are persons employed otherwise than by a contractor, in factories as manager or in industrial establishments as supervisors who are responsible to the employer for supervision and control of the industrial establishment or upon railways if the railway administration has nominated a person in this behalf for a local area, on the person or persons responsible for the regular payment of such wages [S. 3].

Fixation of Wage Periods

Every person responsible for the payment of wages under section 3 is required to fix periods called wage periods in respect of which such wages are to be paid and no wage period must exceed one month [S. 4].

In the fixing of these periods the Act provides that the wages of persons employed in a railway, factory or industrial establishment, in which less than one thousand persons are employed, should be paid before the expiry of the seventh day and that in any other case the same shall be paid before the expiry of the tenth day after the last day of the wage period of which the wages are paid. Thus it will be seen that after the wages fall due, the period of delay cannot be more than seven days in the first case and ten days in the second case after the wages fall due. If, however, the employee's employment is terminated by the employer or on his behalf, the wages due to him must be paid before the expiry of the second working day from the day on which his employment is terminated. All payments of wages must be made on a working day [S. 5] and shall be so payable in current coin or currency notes [S. 6].

However, the employer may, after obtaining the written authorisation of the employed person, pay him the wages either by cheque or by crediting the wages in his bank account.

¹ *Anusuyabai Vithal v. J. H. Mehta* (1959) 61 Bom. L. R. 1417.

Deductions from Wages

Generally speaking, the law expects under the Act that wages of an employed person shall be paid without deduction of any kind except those deductions which the Act specially permits. Even if the wage earner is made to pay an amount to his employer it will be deemed to be deduction from wages under this Act.

The following will not be deemed to be deductions from wages if the rules framed by the employer for such penalties conform to the requirements, if any, specified by the State Government by notification in the official Gazette—

- (1) The withholding of increment or promotion, including the stoppage of increment at an efficiency bar.
- (2) The reduction to a lower post or time scale or to a lower stage in a time scale.
- (3) Suspension.

The following deductions from the wages of an employee may be made in accordance with the provisions of this Act viz.—

[a] fines;

[b] deductions for absence from duty;

[c] deductions or damage to or loss of goods expressly entrusted to the employed person for custody, or for loss of money for which he is required to account, where such damage or loss is attributable to his neglect or default;

[d] deductions for house accommodation supplied by the employer, or by Government or by a housing board;

[e] deductions for amenities and services supplied by the employer as the State Government may, by general or special order, authorise;

NOTE: The “services” here do not include the supply of tools and materials required for the purposes of employment;

[f] deductions for recovery of advances or for adjustments of overpayments of wages;

[g] deductions for recovery of loans made out of fund constituted for the welfare of labour;

[h] deductions for recovery of loans granted for house-building or other purposes approved by the State Government;

[i] deductions of income-tax payable by the employed person;

[j] deductions required to be made by Order of a Court or other competent authority;

[k] deductions for subscriptions and repayment of advances from any provident fund to which the Provident Funds Act 1925 applies or any recognized provident fund under the Indian Income-tax Act [Section 58A] or approved by the State Government;

[l] deductions for payments to co-operative societies approved by the State Government or to a scheme of insurance maintained by the Indian Post Office;

[*m*] deductions made with the written authorisation of the person employed for payment of any premium on his life insurance policy to the Life Insurance Corporation of India established under the Life Insurance Corporation Act 1956 or for the purchase of securities of the Government of India or of any State Government or for being deposited in any Post Office Savings Bank in furtherance of any savings scheme of any such Government;

[*n*] deductions for payment of insurance premia on Fidelity Guarantee Bonds;

[*o*] deductions for recovery of losses sustained by a railway administration on account of (i) acceptance by employee of counterfeit or base coins or mutilated or forged currency notes; (ii) failure of employee to invoice, bill, collect or for appropriate charges due to that administrator; (iii) any rebates or refunds incorrectly granted by the employee where such loss is directly attributable to his neglect or default.

[*p*] deductions made with the written authorisation of the employed person, contribution to the Prime Minister's National Relief Fund, and to such other Fund as the Central Government may by notification in the Official Gazette specify.

The Amendment Act of 1964 however places a ceiling on the total amount of deductions. In respect of (1) above, the amount of such deductions in any wage-period shall not exceed 75 per cent of such wages and in any other case 50 per cent of such wages [S. 7].

Procedure for Imposing Fines

In the case of imposition of fines the Act lays down that the employer, with the previous approval of the State Government or any other prescribed authority, must specify the acts and omissions in respect of which the fine is to be imposed and this notice must be exhibited in the prescribed manner on the premises on which the employment is carried on; in the case of a railway it is to be exhibited at the prescribed place or places. The employee is to be given an opportunity of showing cause against the fine. The total amount of fine which may be imposed in a single wage period on any employee must not exceed an amount equal to half an anna in the rupee of the wages payable to him within that wage period. An employee cannot be fined if he is under fifteen years of age. The fine is to be collected within the expiry of sixty days from the day on which it was imposed and cannot be recovered in instalments. It may be added that for this purpose the fine shall be deemed to have been imposed on the day of the act for which act or omission the employee is fined. The amount recovered in this manner shall be recorded in a register by the person responsible for payment of wages and the money realized is to be applied only to the purposes beneficial to the persons employed in the factory or establishment concerned [S. 8].

Deductions for Absence from Duty

Deductions are allowed to be made on account of the absence of an employed person from the place where he is to work which absence may be for the whole or part of the period fixed. Deductions cannot be in a larger proportion than the period for which he was absent bears to the total period in which by the terms of his employment he was required to work. In this case the absence from work also means absence, where the employee was present but refused to work in pursuance of a stay-in-strike, or for any other cause which is not reasonable. However, subject to rules made by the State Government, if ten or more employed persons acting in concert absent themselves without due notice which is required under the terms of their contracts of employment and without any reasonable cause, the deduction may include such amount not exceeding his wages for eight days as may be and such terms be due to the employer in lieu of due notice [S. 9].

Deductions for damage or loss must not exceed the amount of damage or loss caused to the employer through the neglect or default of the employee and cannot be made until the employed person has been given an opportunity to show cause against the deduction in accordance with the procedure that may be prescribed and these deductions also have to be recorded in a register by persons responsible for the payment of wages [S. 10].

In the case of *deductions for services rendered* such as house accommodation, amenity, etc., the said deduction must not exceed an amount equivalent to the value of the house accommodation, amenity or service supplied [S. 11].

Deductions for recovery of advances, must be made from the first payment of wages in respect of a complete wage-period. No recovery can be made of advances given for travelling expenses. If the employee has not earned the wages which are sought to be dealt with against advances the same will be subject to any rules made by the State Government regulating the extent to which such advances may be given and the instalments by which they may be recovered [S. 12].

Deductions for recovery of loans granted under clause (fff) of sub-section (2) of section 7 shall be subject to any rules made by the State Government regulating the extent to which such loans may be granted and the rate of interest thereon [S. 12-A]

Deductions for payments to cooperative societies and insurance scheme have to be made in accordance with the conditions laid down by the State Government from time to time [S. 13].

Every employer shall maintain registers and records in the prescribed form giving particulars of persons employed by him, the work performed by them, the wages paid to them, the deduction made from their wages, the receipts given by them and such other particulars. Such registers and records shall be preserved for a period of three years after the date of the last entry made therein [S. 13-A].

Inspectors

The Act provides that the Inspector appointed under section 10 (1) of the Factories Act, 1948 shall be an Inspector for the purposes of the Payment of Wages Act. These Inspectors shall act within the local limits assigned to them and in connection with persons employed upon a railway the State Government may appoint Inspectors. The Inspectors have the right to enter any premises at all reasonable hours and make examination of the register or document relating to the calculation or payment of wages and take such evidence as may be desirable on the spot or otherwise [S. 14].

Every employer shall afford an Inspector all reasonable facilities for making any entry, inspection, supervision, examination or inquiry under this Act [S. 14-A].

Claims against Unlawful Deductions

These claims may be heard either by the Commissioner for Workmen's Compensation appointed by the State Government, or other officer with experience as a Judge of a Civil Court or as a stipendiary Magistrate, who is authorized to hear and decide within the specified area all claims arising out of deductions or by reason of a delay in payment of wages, of persons employed or paid in that area. These claims for wrongful deductions may be made by the person himself or on his behalf by his lawyer or a registered trade union authorized to so act on his behalf or by the Inspector under this Act. The application must be presented within 12 months from the date on which deduction was made or the date on which the payment of wages was due to him. If the application is made after the period of 12 months, the same may be admitted if the applicant satisfies the authority that he had sufficient cause for

not making this application in time. The employer concerned will give him an opportunity of being heard and after making such enquiries as the inquiry authority may direct, order a refund to the employee out of the amount deducted and may also impose a penalty. Delayed wages may be ordered to be paid with or without penalty. Compensation may also be ordered by the authority as it may think fit, not exceeding ten times the amount deducted in the former and not exceeding Rs 25 in case of delay in payment of wages. Of course where the delay of payment was due to *bona fide* error or dispute or occurrence of an emergency, or the existence of exceptional circumstances under which the person responsible for payment was unable, though diligent, to make prompt payment, or where there was a failure on the part of the employed person to apply or accept payment, no compensation shall be ordered to be paid if, on the other hand, the authority concerned, after hearing the whole case, is satisfied that the application was malicious or vexatious, the authority may order a penalty not exceeding fifty rupees to be paid to the employer or to the person responsible for payment of wages by the person presenting the application [S. 15].

Appeal

An appeal shall lie under section 17 within 30 days before the court of small causes or the District Court as the case may be, under the following cases—

- (a) by the employer, if the total amount diverted to be paid exceeds Rs 300 or a financial liability exceeding Rs 1,000.
- (b) by the employed person, if the total amount of wages withheld from him exceed Rs 20 or from his co-workers exceeds Rs 50.
- (c) by a person directed to pay a penalty for a malicious or vexatious application.

Sub-section 1-A of section 17 provides that no appeal shall lie unless the memorandum of appeal is accompanied by a certificate by the authority to the effect that the appellant has deposited the amount payable under the direction appealed against.

Duties of Employer

Thus to summarise the duties of the employer, under the *Payment of Wages Act*, are—

- (1) To pay wages on a working day of a prescribed time [S.5].

- (2) To pay wages in current coin or in currency notes, or in both [S. 6].
- (3) To make only authorised deduction [S. 7].
- (4) To impose fines only in respect of the acts and omissions exhibited in the notice [S. 8].
- (5) To display a notice containing prescribed abstracts of the Act and Rule in English and in the language of the majority of the employees in the factory [S. 25].
- (6) To comply with the rules made by the State Government for the maintenance of records, registers, returns, notices etc. [S. 26].

QUESTIONS

1. What is an industrial establishment as defined in the Payment of Wages Act?

2. (a) Section 7 to 13 of the Payment of Wages Act, 1936, constitute, so to say, a complete code in respect of authorised deductions from wages of employed persons. Discuss.

(b) An employee purchases a grinding mill from an agent of the employer. The price of the grinding mill is paid by the employer. The employer now wants to recover the price from the worker by deductions from his wages. Can he do so?

3. What is meant by wages according to Payment of Wages Act? On whom does the responsibility for the payment of wages lie under that Act?

4. State the provisions of the Payment of Wages Act regarding (i) responsibility for payment of wages, (ii) wage-periods, and (iii) the time of payment of wages.

5. What constitute delay and illegal deduction under the Payment of Wages Act? Discuss two types of illegal deduction.

6. Describe the extent of the powers and jurisdiction of the Authority under the Payment of Wages Act. Is the direction given by such authority final?

7. What are the provisions under the Payment of Wages Act, relating to the time of payment of Wages?

8. "Under the Payment of Wages Act, a deduction may become illegal not only because of what is deducted but also because of the extent and manner of deduction."

9. Explain the provisions relating to appeals under the Payment of Wages Act?

Chapter 36

THE MINIMUM WAGES ACT, 1948

IN THE MORE advanced countries statutory provisions already existed for the fixation of minimum wages and it was felt that in a poorly developed country such as India similar statutory provisions were even more necessary. A committee was thus set up and on its recommendation *The Minimum Wages Act, 1948* was passed. This Act extends to the whole of India except the State of Jammu and Kashmir. A major amendment to the Act was made in 1957.

Object of the Act

The primary object is to prevent "Sweated Labour" and exploitation of labour. It has been observed by the Supreme Court of India that what the Act aims at is the statutory fixation of minimum wages with a view to obviate the change of exploitation of labour.

Fixing of Minimum Rates of Wages

The Act provides for the fixation, review and revision by the appropriate Government of the minimum rate of wages payable to employees in the employments mentioned in the Schedule to the Act [S. 3]. Section 2 (b) defines "appropriate Government" as meaning—
(i) in relation to any scheduled employment carried on by or under

the authority of the Central Government or a railway administration, or in relation to a mine, oil-field or major port, or any corporation established by a Central Act, the Central Government (ii) in relation to any other scheduled employment the State Government.

“Cost of living index number” in relation to employees in any scheduled employment in respect of which minimum rates of wages have been fixed, means the index number ascertained and declared by the competent authority by notification in the official Gazette to be the cost of living index number applicable to employees in such employment [S 2 (d)].

“Employer” means any person who employs whether directly or through another person, or whether on behalf of himself or any other person, one or more employees in any scheduled employment in respect of which minimum rates of wages have been fixed under this Act, and includes, except in sub-section (3) of section 26—

- (i) in a factory where there is carried on any scheduled employment in respect of which minimum rates of wages have been fixed under this Act, any person named under clause (f) of sub-section (1) of section 7 of the Factories Act, 1948, as manager of the factory;
- (ii) in any scheduled employment under the control of any Government in India in respect of which minimum rates of wages have been fixed under this Act, the person or authority appointed by such Government for the supervision and Control of employees or where no persons or authority is so appointed, the head of the Department;
- (iii) in any scheduled employment under any local authority in respect of which minimum rates of wages have been fixed under this Act, the person appointed by authority for the supervision and control of employees or where no person is so appointed, the chief executive officer of the local authority;
- (iv) in any other case where there is carried on any scheduled employment in respect of which minimum rates of wages have been fixed under this Act, any person responsible to the owner for the supervision and control of the employees or for the payment of wages. [S. 2 (e)].

“Employee” means any person who is employed for hire or reward to do any work, skilled or unskilled, manual or clerical, in a scheduled employment in respect of which minimum rates of wages

have been fixed; and includes an out-worker to whom any articles or materials are given out by another person, to be made up, cleaned, washed, altered, ornamented, finished, repaired, adapted or otherwise processed for sale for the purposes of the trade or business of that other person where the process is to be carried out either in the home of the out-worker or in some other premises not being premises under the control and management of that other person; and also includes an employee declared to be an employee by the appropriate Government; but does not include any members of the Armed Forces of the Union [S. 2(i)].

“*Wages*” is defined by section 2(h) as meaning all remuneration, capable of being expressed in terms of money, which would, if the terms of the contract of employment, express or implied, were fulfilled, be payable to a person employed in respect of his employment or of work done in such employment, and includes house rent allowance but does not include—

- (i) the value of—
 - (a) any house-accommodation, supply of light, water, medical attendance, or
 - (b) any other amenity or any service excluded by general or special order of the appropriate Government,
- (ii) any contribution paid by the employer to any Pension Fund or provident fund or under any Scheme of social insurance;
- (iii) any travelling allowance or the value of any travelling concession;
- (iv) any sum paid to the person employed to defray special expenses entailed on him by the nature of his employment; or
- (v) any gratuity payable on discharge.

“*Scheduled employment*” is defined by Section 2(g) as meaning an employment specified in the schedule, or any process or branch of work forming part of such employment.

THE SCHEDULE

[See sections 2 (g) and 27]

PART I

1. Employment in any woollen carpet making or shawl weaving establishment.
2. Employment in any rice mill, flour mill, or *dal* mill.
3. Employment in any tobacco (including *bidi* making) manufactory.

4. Employment in any plantation, that is to say, any estate which is maintained for the purpose of growing cinchona, rubber, tea or coffee.
5. Employment in any oil mill.
6. Employment under any local authority.
7. Employment on the construction or maintenance of roads or in building operations.
8. Employment in stone breaking or stone crushing.
9. Employment in any lac manufactory.
10. Employment in any mica works.
11. Employment in public motor transport.
12. Employment in tanneries and leather manufactory.
13. Employment in any residential hotel, restaurant or eating house as defined in the Bombay Shops and Establishments Act, 1948.
14. Employment in any industry in which any process of printing by letter press, lithography, photogravure or other similar work or work incidental to such process or book binding is carried on.
15. Employment in any cotton ginning or cotton pressing manufactory.
16. Employment in glass industry.
17. Employment in any shop or commercial establishment (not being an employment in any bank or an employment which is included) under any of the other entries in this Schedule.

Explanation: For the purpose of this entry, the expressions "shop" and "commercial establishment" shall have the meanings respectively assigned to them in the Bombay Shops and Establishments Act, 1948.

18. Employment in Potteries.
19. Employment in rubber manufacturing industry.
20. Employment in paper and paper-board manufactory.
21. Employment in cinema exhibition industry.
22. Employment in any industry in which any process of transforming plastics into various solid shapes, through moulding, forming, extrusion or casting by application singly or together with heat and/or pressure or both or other similar work or work incidental to such process is carried on.
23. Employment in any hospital not falling under entry 6 in this schedule

Explanation: For the purpose of this entry, "hospital" means any institution for the reception and treatment of persons suffering from illness or mental defectiveness, any maternity home, and any institution for the reception and treatment of persons during convalescence or persons requiring medical rehabilitation, and

includes clinics, dispensaries and out-patient departments maintained in connection with any such institution or home as aforesaid.

24. Employment in brick or roof tiles (terra cotta or earthen) manufactory.
25. Employment in any premises wherein buffaloes or cows or both are kept for milking, cleaning or feeding and for all other ancillary processes.
26. Employment in automobile repairing workshops and garages.
27. Employment in canteens and clubs not falling under entry 13 of Part I of this schedule.
28. Employment in the film production industry.

Explanation: For the purpose of this entry, the expression "film production industry" shall include cine studios, cine laboratories and establishments and activities of cine producers.

29. Employment in powerloom industry.
30. Employment in any industry engaged in saw milling.
31. Employment in any industry in which wooden furniture making or other similar work or any work incidental to such process is carried on.
32. Employment in any industry in which wooden photo or picture frames making and other similar work incidental to such process is carried on.
33. Employment in Bakeries.
34. Employment in Salt-pans.

PART II

1. Employment in agriculture, that is to say, in any form of farming, including, the cultivation and tillage of the soil, dairy farming, the production, cultivation, growing and harvesting of any agricultural or horticultural commodity the raising of live-stock, bees or poultry, and any practice performed by a farmer or on a farm as incidental to or in conjunction with farm operations (including any forestry or timbering operations and the preparation for market and deliver to storage or to market or to carriage for transportation to market of farm produce).

Section 3 (1A) empowers the appropriate Government to *refrain from fixing minimum* rates of wages where in the whole State there are less than one thousand employees in a particular scheduled employment. The minimum rate fixed may be in respect of *time work, piece work, a guaranteed time rate or overtime rate.*

In *fixing or revising* minimum rates of wages under this section [S. 3], *different minimum rates* of wages may be fixed for—

- (i) different scheduled employments,
- (ii) different classes of work in the same scheduled employment,
- (iii) adults, adolescent children and apprentices, and
- (iv) different localities.

Minimum rates of wages may be fixed by any one or more of the following wage periods—

- (i) by the hour,
- (ii) by the day,
- (iii) by the month, or
- (iv) by such other larger wage period as may be prescribed.

Where such rates are fixed by the day or by the month, the manner of calculating wages for a month or for a day, as the case may be, must be indicated [S. 3 (3) (b)].

If, however, any wage periods have been fixed under section 4 of the *Payment of Wages Act*, 1926, minimum wages must be fixed in accordance there with [Proviso to S. 3].

Minimum Rates of Wages

The minimum rate of wages so fixed or revised may consist of—

(1) A basic rate of wages and a special allowance to be adjusted as far as possible with the variation in the cost of living index, or

(2) a basic rate of wages without the cost of living allowance and the cash value of the concession in respect of supplies of essential commodities at concession rates, where so authorised, or

(3) an all-inclusive rate allowing for the basic rate, the cost of living allowance and the cash value of the concession, if any [S. 4.]

It has been held that the *Minimum Wages Act*, 1948, does not cast a statutory obligation upon the State Government to fix or revise the minimum rates of wages strictly according to the cost of living index.¹ In the same case it was held that section 3 (3) (a) (iv) of the *Minimum Wages Act*, 1948, which states that different rates of wages may be fixed for different localities is not discriminatory and therefore it does not violate the provisions of Article 14 of the Constitution, namely, "equality before the law".

Section 5 provides the procedure for fixing or revising minimum rates of wages either by the appropriate Government (1) appointing committees and sub-committees to inquire and advise or (2) by notification in the official Gazette subject to previous publication of the proposals. The Advisory Board must also be consulted where the appropriate Government proposes to revise the minimum rates by the second method i.e. by notification.

¹ *Bhikusa v. Songamner Bldi Kamgar Union* (1956), 61 Bom. L. R., 764

It was held in a recent case that under the powers conferred by section 5 the appropriate Government can only interfere with the terms of the contract between the employer and the employee so far as they relate to the fixation of wages for the work done in the employment and not with any of the other terms.²

Principles Governing the Fixation of Minimum rates of Wages

While fixing rates of Minimum Wages, the basic requirements of the workers must be covered. The concept of "Minimum Wages" in the context of the Act includes only what is required by the worker for subsistence of himself and his family and the preservation of his efficiency. In calculating it, food, clothing, rent, education and medical aid are admissible items but nothing else is admissible.

When determining Minimum Wages for the purpose of the Act, the financial capacities of the employer is a factor which has no relevance at all. In an area where the prevailing rates of wages are very low, it is open to the Government to fix minimum wages at a level higher than the one obtaining in comparable concerns in that area.

Constitutionality of the Provisions of the Act

In *Edward Mills Co. Ltd., Bewar, State of Ajmer*³ it was held by the Supreme Court of India that S. 27 confers on the Government powers to bring any employment within the operation of the Act by adding it to the schedule as a piece of constitutional legislation which is constitutional and valid.

It cannot be said that S. 27 is a piece of uncontrolled delegation of legislative power to execute because the Act clearly lays down its policy and the standards which must judge the Government in the exercise of its power under S. 27.

Advisory Board

For the purposes of co-ordinating the work of all the above-mentioned committees and sub-committees the appropriate Government is required by section 7 to appoint an *Advisory Board*. For co-ordinating the work of the Advisory Boards and to advise the Central and State Governments regarding the fixation and revision of minimum rates of wages and other matters in the Minimum

² *Bidi & Tobacco Merchants' Association v. State* (1959), 61 Bom. L. R. 890

³ A.I.R. 1955, S.C. 25

Wages Act, the Central Government is required to appoint a *Central Advisory Board* consisting of persons nominated by the Central Government representing in equal number employers and employees in the scheduled employments, and independent persons not exceeding one-third of its total number of members. One of such independent persons must be appointed Chairman of the Board by the Central Government [S. 8].

A similar provision is made by section 9 for the composition of committees, sub-committees and the Advisory Board, the appointment being by the appropriate Government.

Wages in Kind

Minimum wages under the Act must be paid in cash. The appropriate Government may, however, by notification in the official Gazette authorise payment partly or wholly in kind provided this been the custom. The appropriate Government may by notification in the official Gazette also authorise the provision of essential commodities at concession rates. The cash value of wages in kind and of concessions must be estimated in the prescribed manner [S.11].

Fixing of Hours of Work

Where minimum wages have been fixed in regard to any scheduled employment, appropriate Government may—

(1) fix the number of hours of work which should constitute a normal working day, inclusive of one or more specified intervals;

(2) provide for a day of rest in every period of seven days which should be allowed to all employees or to any specified class of employees and for the payment of remuneration in respect of such days of rest;

(3) provide for payment of work on a day of rest at a rate not less than the overtime rate.

These provisions will apply only to the extent and subject to such conditions as may be prescribed in the case of the following class of employees—

(1) employees engaged on urgent work, or in any emergency which could not have been foreseen or prevented;

(2) employees engaged in preparatory or complementary work which must necessarily be carried on outside the limits laid down for the general working in the employment concerned;

(3) employees whose employment is essentially intermittent;

(4) employees engaged in any work which for technical reasons has to be completed before the duty is over;

(5) employees engaged in a work which could not be carried on except at times dependent on the irregular action on natural forces [S. 13].

Provision is made for the payment of *overtime* [S. 14] and for the payment as for a full normal working day to a worker who works for less than a normal working day unless the failure to work is caused by his unwillingness to work and not by the omission of the employer to provide him with work, and in such other cases and circumstances as may be prescribed [S. 15]. A worker who does two or more classes of work to which a different minimum rate of wages is applicable is entitled to be paid, for the time respectively occupied in each class of work, wages at not less than the minimum rate in force in respect of each class [S. 16].

When a minimum time rate is fixed for piece work the employer will have to pay wages at not less than the minimum time rate [S. 17]. The Act provides for the maintenance of register and records containing the prescribed particulars [S. 18].

Inspectors and Authority to Decide Claims

The appropriate Government may, by notification in the official Gazette, appoint Inspectors who will be deemed public servants and define the local limits of their powers. Inspectors have the *following powers*—

(1) to enter the premises at reasonable hours with or without appropriate assistants;

(2) to examine persons there whom he believes to be employees;

(3) to require from persons giving outwork or outworkers any information regarding names and addresses of such persons and with respect to payments to be made for the work;

(4) to seize or take copies of such registers, record of wages or notices or portions thereof as he may consider relevant in respect of an offence under the Act which he has reason to believe has been committed by an employer;

(5) exercise such other powers as may be prescribed.

Persons so required to produce any document or thing or to give any information by an Inspector are legally bound to do so [S. 19].

Claims

For hearing and deciding claims arising out of payment of less than the minimum rates of wages or in respect of the remuneration for days of rest or for work done on such days or wages at the overtime rate to employees employed or paid in that area, the appropriate Government may appoint any Commissioner or Workmen's Compensation or any officer of the Central Government exercising functions as a Labour Commissioner for any region, or any officer of the State Government not below the rank of Labour Commissioner or any other officer with experience as a Judge of a Civil Court or as a stipendiary Magistrate. If Authority is satisfied that an application for such a claim was either malicious or vexatious, it may impose a penalty up to Rs 50 to be paid by the applicant to the employer [S. 20].

Penalties and Exemptions

Section 22 to 22C state the penalties and procedure for the contravention of various provisions of the Act while section 23 provides for exemption of the employer from liability if he first proves before the Court that some other person was the actual offender and then satisfies the Court that he has used due diligence to enforce the execution of this Act and that the other person charged by him committed the offence in question without his knowledge, *consent* or connivance.

Section 26 empowers the appropriate Government, subject to conditions if any, to direct that the provisions of this Act shall not apply in relation to wages payable to disabled employees or by notification in the official Gazette direct that subject to such conditions and for a specified period some or all the provisions of the Act shall not apply to all or any class of employees in any scheduled employment. The appropriate Government may also notify that the provisions of the Act shall not apply to any class of employees, in a scheduled employment generally or in a scheduled employment in a local area or to any establishment or part of any establishment in a scheduled employment, having regard to their terms and conditions of service.

It is also provided that the provisions of this Act will not apply to the wages payable by an employer to a member of his family who is living with and is dependent on him [S. 26].

Powers of Central Government

The Central Government is also empowered—

- (1) to add to the schedule by notification subject to the condition of previous publication [S. 27].
- (2) to give directions to a State Government as to the carrying into execution of this Act in the State [S. 28], and
- (3) to make rules [Ss. 29 & 30].

Duties of Employer

The following in brief are the duties of the employer under the *Minimum Wages Act*—

- (1) To pay wages at a rate not less than the minimum rate [S. 12].
- (2) To make only authorised deductions [S.12].
- (3) To pay overtime at rates fixed under the Act or under any law of the appropriate Government, whichever is higher [S. 14].
- (4) To maintain the registers and records containing the prescribed particulars of employees, work performed, wages paid, receipts given etc. [S. 18].
- (5) To exhibit in the prescribed manner the required notices [S.18].
- (6) To issue wage work and wage slips and authenticate entries in them in the prescribed manner [S.18].

QUESTIONS

1. (a) Discuss the provisions of the Minimum Wages Act, 1948, according to which the employer must pay to his employees a minimum wage. What are the consequences of failure to pay the minimum wage?
(b) Can a single application be made on behalf of or in respect of a number of employees under Section 20 of the Act?
2. What are the remedies available to the worker who had been paid less than minimum rates of wages? State also the procedure for final determination of dispute.

Chapter 37

THE PAYMENT OF BONUS ACT, 1965

THE PROVISIONS OF this Act came into operation on May 29th, 1965, through an ordinance. The ordinance was subsequently replaced by the Act which came into force on 25th September 1965.

Concept of Bonus

According to the Bonus Commission's Report, the concept of bonus was construed as "sharing by the workers in the prosperity of the concern in which they are employed". They further contended that "in the case of low paid workers such sharing in prosperity augments their earnings and so helps to bridge the gap between the actual wage and the need-based wage". A properly conceived bonus system linked to profit undoubtedly provides a measure of desirable flexibility to the wage-structure.

Application

This Act applies to (a) every factory as defined in the Factories Act, 1948 and (b) every other establishment in which 20 or more persons are employed on any day during an accounting year. Subse-

quent reduction to less than 20 employees will not make the Act inapplicable (S.1). The word "establishment" is a far wider term than "factory".

Where an establishment consists of different departments or undertakings or has branches, whether situated in the same place or in different places, all such departments or undertakings or branches shall be treated as parts of the same establishment for the purpose of computation of bonus under this Act but where a separate balance sheet and profit and loss account are prepared and maintained in respect of any such department or undertaking or branch, then they shall be treated as a separate establishment for the purpose of computation of bonus under this Act.

Minimum Bonus

The Act provides for payment by the employer to every employee in an accounting year of a minimum bonus of 4 per cent of the salary or wage earned by the employee during the accounting year or Rs 40 (Rs 25 in case of employees under 15 years of age) whichever is higher irrespective of whether there are profits in the accounting year or not (S.10). This provision is a deviation from the well-recognised principle that bonus should be payable only out of profits.

An employee is defined by the Act as meaning—

any person (other than an apprentice) employed on a salary or wage not exceeding Rs 1,600 per mensem in any industry to do any skilled or unskilled manual, supervisory, managerial, administrative, technical or clerical work for hire or reward, whether the terms of employment be express or implied; [S.2(13)].

An employee is defined as including—

- (i) in relation to a factory, the owner or occupier of the factory including his agent, the legal representative of a deceased owner or occupier and a person named as manager of the factory under the Factories Act 1948;
- (ii) in relation to any other establishment, the person or authority having ultimate control over the affairs of the establishment and where such affairs are entrusted to a manager, managing director or managing agent, such manager, managing director or managing agent [S.2(14)].

Eligibility for Bonus

Every employee is entitled to payment of bonus in an accounting year in accordance with the provisions of this Act provided he has worked in the establishment for not less than 30 working days in that year [S.8]. An employee is however *disqualified* from receiving bonus under this Act if he is dismissed from service for—

- (a) fraud; or
- (b) riotous or violent behaviour while on the premises of the establishment; or
- (c) theft, misappropriation or sabotage of any property of the establishment [S.9].

Computation of Gross Profit

The Act provides for the computation of gross profits in respect of any accounting year providing a different mode of computation in case of a banking company (detailed in the First Schedule) than in case of other establishments (detailed in the Second Schedule). (S. 4).

Available Surplus and Maximum Bonus

The Act provides for calculation of "available surplus" as the gross profits after deducting certain sums such as depreciation and development rebate or allowance admissible under the Income-tax Act. [Sections 5 and 6 and Schedules]. If such surplus exceeds the minimum bonus payable, the employer is required to pay such surplus, in lieu of such minimum bonus, in proportion to the salary or wages of the employees subject to a maximum of 20% of such salary or wage [S.11]. In case of employees whose salary or wage exceeds Rs 750 per month, the bonus will be calculated as if his salary or wage were Rs 750 per month [S.12]. The excess of allocable surplus not distributed is carried forward for being set on upto the fourth succeeding accounting year [S.15]. Normally allocable surplus is 60 per cent of such available surplus. It is 67 per cent of the available surplus in an accounting year in case of a company (not being a banking company) which has not made arrangements under the Income-tax Act for the declaration and payment within India of dividends payable out of the profits in accordance with provisions of section 194 of that Act [S.(2)(4)].

The Limit for Payment

The bonus payable to the employee under this Act must be paid in cash by the employer within a period of 8 months from the close of the accounting year. If there is a dispute regarding payment of bonus, it must be paid within a month from the date on which the award becomes enforceable or the settlement comes into operation [S.19].

Exempted Class of Employees

The Act however does not apply to certain classes of employees. For example, it does not apply to employees of the Life Insurance

Corporation of India, insurer carrying on general insurance business, seamen under the Merchant Shipping Act, 1958, the Indian Red Cross Society, universities and other educational institutions as well as institutions not established for the purpose of profit [S. 32].

Salient Features of the Payment of Bonus (Amendment) Ordinance 1972

The Ordinance, which has been promulgated on 23-9-1972 has brought into effect certain important modifications to the Principal Act, which may be enumerated as follows—

- (1) The rate of minimum bonus has been raised from 4 per cent to $8\frac{1}{3}$ per cent (which comes to month's wages in a year) of the wages or salary earned by the employee during the accounting year commencing on any day in the year 1971 or Rs 80 whichever is higher, irrespective of profits made or not in that accounting year.
- (2) Those employees who have not completed fifteen years of age will be entitled to receive Rs 80 in that accounting year.
- (3) The maximum bonus payable to an employee in accounting year is restricted to 20 per cent of the salary or wages of the employee.
- (4) The bonus in excess of the quantum paid or payable in respect of the previous accounting year shall be credited to the Provident Fund accounts of the employees concerned.
- (5) An employee having no Provident Fund Account shall be paid the bonus in cash, when the bonus does not exceed $8\frac{1}{3}$ per cent. For 1971, the entire money is to be paid in cash.

The Payment of Bonus (Amendment) Act 1976

The amending Act provides for the payment of bonus to persons employed in certain establishments on the basis of production and productivity and for matters connected therewith. Factories and establishments employing twenty or more persons are covered by the Act. The appropriate Government has also the power to make the Act applicable to establishments employing ten or more persons.

Amount of Bonus

The amount of bonus payable to an employee under the Act is based on allocable surplus of profits. The allocable surplus is a percentage of the available surplus which in turn is the gross profits of the accounting year less depreciation, development rebate, direct taxes and certain other prior charges.

Where an employer has any allocable surplus in any accounting year, then he shall be bound to pay to every employee in respect of that accounting year a minimum bonus which shall not be less than

four per cent of the salary or wages earned by the employee during the accounting year or one hundred rupees whichever is higher. In the case where the allocable surplus exceeds the said amount of minimum bonus payable to the employees, there shall be payable an amount in proportion to the salary or wage earned by the employee during the accounting year subject to a maximum of twenty per cent of such salary or wage. However, where the employee has not completed fifteen years of age at the beginning of that accounting year, the minimum bonus will be limited to sixty rupees instead of one hundred rupees.

Bonus Linked to Productivity

The amending Act provides for agreements or settlements between the employer and the employee for payment of bonus linked with production. This payment shall be in lieu of bonus payable based on profits as provided under the Act. Where such agreements or settlements are entered into between the employer and the employee, or even where they are in existence previously, the employees will be entitled to receive bonus due to them under such agreements or settlements as the case may be. However such employees shall not be entitled to be paid such bonus in excess of twenty per cent of the salary or wage earned by them during the relevant accounting year.

The Payment of Bonus (Amendment Act 1977)

The Amending Act has raised the minimum bonus to 8.33 per cent of salary or wages payable to the employee in the Accounting Year. There is no change in the maximum bonus payable which remains at 20 per cent.

The Act is now applicable to Banking Companies and the Industrial Reconstruction Corporation of India. Calculation of gross profits in the case of Banking companies is now indicated through a schedule incorporated in the Act. Deduction of investment allowance from income under the Income Tax Act is now permitted to be arrived at from gross profits. Audited accounts of banking companies are not liable to be questioned now in any dispute under the Act.

Bonus may be paid based on production and productivity. Even here it shall not be less than 8.33 per cent. Employers and Employees may also agree for payment of bonus under a formula different from the one laid down by the Act. But such agreements require the approval of the appropriate Government and a minimum of 8.33 per cent has to be paid. The maximum shall not also exceed 20 per cent.

Chapter 38

WORKMEN'S COMPENSATION ACT, 1923

THE WORKMEN'S COMPENSATION Act, 1923 creates a *liability to pay compensation according to fixed rates subject to fixed maxima for injury by accident under certain circumstances and not to pay damages*. The idea here is that if a workman employed in the services or employment, meets with an accident or injury, the employer would become liable under certain circumstances to pay compensation to the workman or to those dependent upon him.

The *object* of the Act is to place an obligation upon certain types of employers and make them liable to pay compensation for personal injuries to their workers by *accidents* arising out of and in the course of employment which result in their total or partial disablement for a period exceeding 3 days, as well as for certain *occupational diseases*, such as anthrax, poisoning by lead, phosphorous, mercury, etc.¹ The administration of this Act is entrusted to the State Government by whom *Commissioners* are appointed for settlement of questions arising under the Act. All *fatal accidents* as well as accidents resulting in serious bodily injury must be *reported to such Commissioners* by the employer within seven days of the

¹ See Schedule III

death or serious bodily injury. The words "*serious bodily injury*" have been added by the Amendment Act of 1959 and mean "an injury which involves, or in all probability will involve, the permanent loss of the use of, or permanent injury to, any limb, or the permanent loss of or injury to the sight or hearing, or the fracture of any limb, or the enforced absence of the injured person from work for a period exceeding twenty days." If a contract is entered into between the employer and the workman with regard to the amount of compensation, such a contract must be registered with the Commissioner. There were various amendments to the Act of 1923, the most important being Act XV of 1933, Act I of 1946, and Act 8 of 1959. The Amending Acts extended the scope of this type of legislation to include new industries, occupations, and occupational diseases. The scale of benefit was also increased and the amount of compensation for death was raised. Widows, daughters, sisters, illegitimate minor children etc. were also included amongst dependants for compensation. The Act thus revised covers railways, tramways, factories, mines, docks, electricity, aircraft, tubewells circuses etc.

Definitions

The terms *workman* and *employer* are defined in section 2 of the Act as follows—

"*workman*" means any person (other than a person whose employment is of a casual nature and who is employed otherwise than for the purposes of the employer's trade or business) who is—

(i) A railway servant as defined in section 3 of the Indian Railways Act, 1890,² not permanently employed in any administrative, district or sub-divisional office of a railway and not employed in any such capacity as is specified in Schedule II, or

(ii) employed on monthly wages not exceeding one thousand rupees, in any such capacity as is specified in Schedule II, whether the contract of employment was made before or after the passing of this Act and whether such contract is expressed or implied, oral or in writing; but does not include any person working in the capacity of a member of the Armed Forces of the Union and any reference to a workman who has been injured shall, where the workman is dead, include a reference to his dependants or any of them.

"*employer*" includes body of persons whether incorporated or not and any managing agent of an employer and the legal representative of a deceased employer, and, when the services of a workman are

² IX of 1890

temporarily lent or let on hire to another person by the person with whom the workman has entered into a contract of service or apprenticeship, means such other person while the workman is working for him.

Dependent

Relations of the workmen are divided into three categories. In the first category are included a widow, minor legitimate son, and unmarried legitimate daughter or a widowed mother. These would be considered to be the dependents of a workman whether in fact they are dependent on the earnings of the workman or not. The second category includes a son or a daughter who has attained the age of 18 years and who is infirm, if he or she is wholly dependent on the earning of the workman at the time of his death. The third category includes a widower, a parent other than a widowed mother, a minor illegitimate son, an unnamed illegitimate daughter, a daughter whether legitimate or illegitimate, if married and minor, or if widowed and a minor, a widowed daughter-in-law, a minor child of a deceased son, a minor child of a deceased daughter where no parent of the child is alive, or where no parent of the workman is alive, a paternal grandparent. The right of the persons in the third category to share in the compensation payable under the Act is dependent on their having been dependent on the earnings of the deceased workman at the time of his death. The question whether "widowed mother" or parent other than widowed mother would include a step-mother had come up for consideration before the Calcutta High Court and it was held that a step-mother was not covered by these expressions. It had, however, been held by the Nagpur High Court that the expression "widowed mother" would include an adoptive widowed mother.

When Employer Not Liable

The employer is not liable—

(1) if the injury does not result in the total or partial disablement of the workman for at least three days, or

(2) if the injury, not resulting in death was caused by an accident which is directly attributable to (a) the workman being, at that time under the influence of drink or drugs, or (b) the wilful disobedience of the workman to an order expressly given, or to a rule expressly framed for securing his safety or (c) the wilful removal or disregard by the workman of any safety guard or other device which to his knowledge was provided for the purpose of securing his safety, or

(3) if the accident did not arise out of and in the course of the employment, or

(4) if the workman has instituted in a Civil Court a suit for damages in respect of the injury against the employer or any other person with regard to 2 (b) above, it has been held that *mere negligence* on the part of the workman *does not amount to wilful disobedience* by the workman to an order expressly given.³ It has been held that the Workmen's Compensation Act does not make provision for the reduction of the scheduled compensation on the score of any *contributory negligence* on the part of a workman who dies in consequence of injuries which he receives in the course of his employment which ordinarily would not be fatal or which in fact, as in the present case, are simple.⁴

When Employer Liable

The Act provides that when a workman is employed in any employment mentioned in Part A of Schedule III (which is given later on) contracts any disease specified therein as an *occupational disease* peculiar to that employment the contracting of such disease would be deemed to be an injury by *accident*. The position is the same where a workman who has been in continuous employment for a period of not less than 6 months which period must not include a period of service under any other employer in the same kind of employment—in any employment specified in Part B of Schedule III contracts an occupational disease peculiar to that employment or if a workman whilst in the service of one or more employers in any employment specified in Part C of Schedule III for such continuous period as the Central Government may specify, contracts any disease specified therein as an occupational disease peculiar to that employment. Part C has been inserted by the Amendment Act of 1959 which has also added sub-sections 2A to section 3 to the effect that if any disease specified in Part C of Schedule III as an occupational disease peculiar to that employment has been contracted by any workman during the continuous period not less than 6 months not including a period of service under any other employer in the same kind of employment, and the workman has during such period been employed in such employment under more than one employer, all such employers will be liable for the payment of compensation in such proportion as the Commissioner may deem just in the circumstances.

³ *Allah Baksh v. Mohammad Allah Baksh*, A.I.R. 1935 Cal. 670

⁴ *Abdullah Kutty v. Cheriampambatt Janaki*, M.R. 1953 Mad. 837

Power is given, to the State Government in the case of employments specified in Parts A & B of Schedule III, and to the Central Government in case of Part C, to add any description of employment by notification in the Official Gazette after giving at least 3 months' notice of such intention in the Official Gazette. The accident will be deemed to have arisen out of and in the course of the employment unless the employer proves the contrary. Thus the burden of proof has now been placed on the employer and not on the employee. It should be noted that for any other disease the workman will not be able to recover compensation unless the disease is directly attributable to a specific injury by accident arising out of and in the course of his employment [S.3(4)].

The employment of the workman does not necessarily commence from the moment when he reaches the place where he has to begin his work and to the moment when he ceases that work. A reasonable interval of time and space has to be included.⁵

When a workman is employed to do a particular work and he goes outside his own sphere and interferes with a machine which has nothing to do with his work and which is assigned to some other workman, he cannot claim compensation.⁶ If, however, *though in the course of employment the accident which has occurred is an ordinary accident of life, there can be no claim for compensation:* as for example in one case a workman sprained his finger while removing his socks preparatory to his work or where a man was seized with giddiness causing him to fall down-stairs it was held that a claim did not arise out of an accident specially connected with the employment.⁷

Thus to put it briefly, the workman will be entitled to get compensation from his employer if he can show that the injury was caused by accident which arose out of and in the course of his employment, irrespective of the question of negligence on the part of either the employer or employee, and if the workman was at the time of the injury engaged in the business of his employer and not engaged on his own or someone else's work.

It has been held by the Bombay High Court⁸ that whereas "the course of the employment" emphasises the time when accidental

⁵ *Gana v. Norton Hill Colliery Co.* (1909), 2 K.B. 539

⁶ *Love v. Pearson* (1899), 1 Q.B. 261

⁷ *Peel v. Lawrence & Sons Ltd.*, (1912) 5 B.W.C.C. 274; *Buttler v. Burton-on Trent Union* (1912,) 5 B. W.C.C. 355

⁸ *Laxmibai A. Karangutkar v. The Chairman and Trustees Bombay Port Trust* 55, Bom. L.R. 924

injury was caused, "out of employment" emphasises that there must be a casual connection between the employment and the accident injury. A workman is considered to be acting in the course of his employment when he is engaged in doing something he was employed to do or when he is doing something in discharge of a duty to his employer directly or indirectly imposed on him by his contract of service. A workman is ordinarily considered to begin his employment as soon as he reaches the place where he is supposed to be doing his work. A workman who suffers from an accident during transit on work undertaken on behalf of his employer but out of his ordinary place of work is covered by the words "arising in the course of the employment".

For an accident to arise out of employment, the risk of such an accident must to a greater or lesser degree have been inherent in the employment before the accident occurred. In another case³ it was held that if the employment is a contributory case, or if the employment has accelerated the death, or if it could be said that the death, was due not only to the disease but the disease coupled with the employment, then the employer would be liable and it could be said that the death arose out of the employment of the deceased workman.

Liability for Contractors' employees

Generally it is the employer who is liable to compensate a worker for injuries suffered by him through an accident arising out of and in the course of his employment. There are, however, cases when the employer or "principal" engages a contractor for the execution of the whole or any part of any work which has to be done by or for him. If in the course of his employment by such a contractor a workman suffers an injury, the question naturally arises as to who would be liable to pay compensation—the contractor or the principal. If the contractor is engaged to do wholly or partly work which ordinarily forms part of the trade or business of the principal, the principal would be liable to pay compensation as if he were the direct employer. However, where the principal is so required to pay compensation to an injured workman or to the dependents of a deceased workman, he shall be entitled to be indemnified by the contractor to the extent of the liability thrown upon him in that respect. All question as to the right to and the amount of any such indemnity are to be settled by the commissioner for workmen's compensation. Any contractor who is liable to pay

³ *Trustees of the Port of Bombay v. Yamunabai* 54 Bom. L.R. 421

compensation or to indemnify a principal is also entitled to be indemnified by any person standing to him in relation of a contractor from whom the workman could have recovered compensation. This gives the contractor a right to be indemnified by a sub-contractor, if he has to pay compensation or to indemnify a principal.

Schedule III referred to above is as shown below—

SCHEDULE III

List of Occupational Diseases

Occupational disease	Employment
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PART A

Anthrax	Any employment— (a) involving the handling of wool, hair, bristles or animal carcasses or parts of such carcasses, including hides, hoofs and horns; or (b) in connection with animals infected with anthrax; or (c) involving the loading, unloading or transport of any merchandise.
Compressed air illness of its sequelae.	Any process carried on in compressed air.
Poisoning by lead tetra ethyl.	Any process involving the use of lead tetra-ethyl.
Poisoning by nitrous fumes.	Any process involving exposure to nitrous fumes.
Poisoning by Organic Phosphorous insecticides.	Any process involving the use or handling or exposure to the fumes, dust or vapour containing any of the organic phosphorous insecticides

PART B

Poisoning by lead its alloys, or compounds, or its sequelae excluding poisoning by lead tetra-ethyl.	Any process involving the handling or use of lead or any of its preparations of compounds except lead tetra-ethyl.
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Occupational disease	Employment
PART B. (Contd.)	
Poisoning by phosphorous or its compounds, or its sequelae.	Any process involving the use of phosphorous or its preparations or compounds.
Poisoning by mercury, its amalgams and compounds, or its sequelae.	Any process involving the use of mercury or its preparation or compounds.
Poisoning by benzene, or its homologues, their amido and nitro-derivatives or its sequelae.	Any process involving the manufacture, liberation, or use of benzene, benzene homologues and their amido and nitroderivatives.
Chrome ulceration or its sequelae.	Any process involving the use of chromic acid or bichromate of ammonium, potassium or sodium, or their preparations or the manufacture of bichromate.
Poisoning by arsenic or its compounds, or its sequelae.	Any process involving the production, liberation or utilisation of arsenic or its compounds.
Pathological manifestations due to—	Any process involving exposure to the action of radium, radio-active substances, or X-rays.
(a) radium and other radio-active substances;	Any process involving the handling or use of tar, pitch, bitumen, mineral oil, paraffin, or the compounds, products or residues of these substances.
(b) X-rays. Primary epithellomatous cancer of the skin.	Any process involving the manufacture, liberation and use of hydrocarbons of the aliphatic series and their halogen derivatives.
Poisoning by halogenated hydrocarbons of the aliphatic series and their halogen derivatives.	

Occupational disease	Employment
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PART B (Contd.)

Poisoning by carbon disulphide or sequelae.	Any employment in— (a) the manufacture of carbon disulphide; or (b) the manufacture of artificial silk by viscose process, or (c) rubber-industry; or (d) any other industry involving the production or use of products containing carbon disulphide or exposure to emanation from carbon disulphide.
Occupational cataract due to infrared radiations.	Any manufacturing process involving exposure to glare from molten material or to any other sources of infra-red radiations.
Telegraphist's Cramp.	Any employment involving the use of telegraphic instruments.
Poisoning by manganese or a compound of manganese, or its sequelae.	Any process involving the use of or handling of, or exposure to the fume, dust or vapour of, manganese or a compound of manganese, or a substance containing manganese.
Poisoning by— Organic phosphorous insecticides hexa-ethyl tetraphosphate (HETP), Tetraethyl pyrophosphate (TEPP3), and oo,-diethylo-p. nitro-phenyl-thiophosphate (PARATHION).	Any process involving the use, handling or exposure of the fumes, dust or vapour containing any of the organic phosphorous insecticides.

Occupational disease	Employment
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PART C

Silicosis.	Any employment involving exposure to the inhalation of dust containing silica.
Coal Miners' Pneumoconiosis.	Any employment in coal mining.
Asbestosis.	Any employment in (1) the production of— (i) fibro cement materials or (ii) asbestos mill board or (2) the processing of ores containing asbestos.
Bagassosis	Any employment in the production of bagasse mill board or other articles from bagasse.

Who is a Workman?

"Workman" is defined by section 2(1) (n) of the Workmen's Compensation Act of 1923 as any person (other than a person whose employment is of a casual nature and who is employed otherwise than for the purposes of the employer's trade or business) who is—

(i) a railway servant as defined in section 3 of the Indian Railways Act, 1890, not permanently employed in any administrative, district or sub-divisional office of a railway and not employed in any such capacity as is specified in Schedule II; or

(ii) employed on monthly wages not exceeding one thousand rupees, in any such capacity as is specified in Schedule II, whether the contract of employment was made before or after the passing of this Act and whether such contract is expressed or implied, oral, or in writing; but does not include any person working in the capacity of a member of the Armed Forces of the Union any reference to a workman who has been injured shall, where the workman is dead, include a reference to his dependants or any of them.

Schedule II as referred to above further elaborates the definition by stating that *the following persons would fall under the heading of workman within the meaning of Section 2(1) (n)*—any person who is—

(i) employed, otherwise than in a clerical capacity or on a railway, in connection with the operation or maintenance of a lift or a vehicle propelled by steam or other mechanical power or by electricity or in connection with the loading or unloading of any such vehicle; or

(ii) employed, otherwise than in a clerical capacity in any premises wherein or within the precincts whereof manufacturing process as defined in clause (k) of section 2 of the Factories Act, 1948 is being carried on or in any kind of work whatsoever incidental to or connected with any such manufacturing process or with the article made, (whether or not employment in any such work is within such premises or precincts) and steam, water or other mechanical power or electrical power is used; or

(iii) employed for the purpose of making, altering, repairing, ornamenting, finishing or otherwise adopting for use, transport or sale any articles or part of an article in any premises wherein or within the precincts whereof twenty or more persons are so employed;

Explanation—For the purposes of this clause, persons employed outside such premises or precincts but in any work incidental to, or connected with the work relating to making, altering, repairing, ornamenting, finishing or otherwise adapting for use, transport or sale any article or part of an article shall be deemed to be employed within such premises or precincts; or

(iv) employed in the manufacture or handling of explosives in connection with the employers trade or business; or

(v) employed, in any mine as defined in clause (f) of section 2 of the Mines Act, 1952, in any mining operation, or in any kind of work, other than clerical work, incidental to or connected with any mining operation or with the mineral obtained, or in any kind of work whatsoever below ground; or

Provided that any excavation in which on no day of the preceding twelve months more than fifty persons have been employed or explosives have been used, and whose depth from its highest to its lowest point does not exceed twenty feet, shall be deemed not to be a mine for the purpose of this clause; or

(vi) employed as the master or as a seaman of—

(a) any ship which is propelled wholly or in part by steam or other mechanical power or by electricity or which is towed or intended to be towed by a ship so propelled; or

(b) any ship not included in sub-clause (a) of twenty-five tons net tonnages or over, or

(c) any sea-going ship not included in sub-clause (a) or sub-clause (b) provided with sufficient area for navigation under sails alone; or

(vii) employed for the purpose of —

[a] loading, unloading, fuelling, constructing, repairing, demolishing, cleaning or painting any ship of which he is not the master or a member of the crew, or handling or transport within the limits of any port subject to the Indian Ports Act, 1908, of goods which have been discharged from or are to be loaded into any vessel; or

[b] warping a ship through the lock; or

[c] mooring and unmooring ships at harbour wall berths or in pier; or

[d] removing or replacing dry dock calsoons when vessels are entering or leaving dry docks; or

[e] the docking or undocking of any vessel during an emergency; or

- [f] preparing spicing coir springs and check wires, painting depth marks on lock-sides, removing or replacing fenders whenever necessary landing of gangways, maintaining life-buoys up to standard or any other maintained work of a like nature; or
- [g] any work on jolly-boats for bringing a ship's line to the wharf; or
- (viii) employed in the construction, repair or demolition of—
 - [a] any building which is designed to be or has been more than one storey in height above the ground or twelve feet or more from the ground level to the apex or the roof; or
 - [b] any dam or embankment which is twelve feet or more in height from its lowest to its highest point; or
 - [c] any road, bridge, tunnel or canal; or
 - [d] any wharf, quay, sea-wall or other marine work including any moorings of ships; or
- (ix) employed in setting up, maintain, repairing, or taking down any telegraph or telephone line or post of any overhead electric line of cable or post or standard or fittings and fixtures for the same; or
- (x) employed, otherwise than in a clerical capacity, in the construction working, repair or demolition of any aerial ropeway, canal pipe-line, or sewer; or
- (xi) employed in the service of any brigade; or
- (xii) employed upon a railway as defined in clause [4] of Section 3, and subsection (1) of Section 148 of the Indian Railways Act, 1890, either directly or through a sub-contractor, by a person fulfilling a contract with the railway administration; or
- (xiii) employed as an inspector, mail guard, sorter or van peon in the Railway Mail Service or as a telegraphist or as a postal or railway signaller or employed in any occupation ordinarily involving outdoor work in the Indian Posts and Telegraphs Department; or
- (xiv) employed, otherwise than in a clerical capacity, in connection with operations for winning natural petroleum or natural gas; or
- (xv) employed in any occupation involving blasting operations; or
- (xvi) employed in the making of any excavation in which on any one day of the preceding twelve months more than twenty-five persons have been employed or explosives have been used, or whose depth from its highest to its lowest points exceeds twelve feet; or
- (xvii) employed in the operation of any ferry boat capable of carrying more than ten persons; or
- (xviii) employed, otherwise than in a clerical capacity, on any estate which is maintained for the purpose of growing cardamom, cinchona, coffee, rubber or tea, and on which on any one day in the preceding twelve months twenty-five or more persons have so been employed; or

(xix) employed, otherwise than in a clerical capacity, in the generating, transforming, or supplying of electrical energy or in the generating or supplying of gas; or

(xx) employed in a light-house as defined in clause (d) of Section 2 of the Indian Lighthouse Act, 1927; or

(xxi) employed in producing cinematograph picture intended for public exhibition or in exhibiting such pictures; or

(xxii) employed in the training, keeping or working of elephants or wild animals; or

(xxiii) employed in the tapping of palm-tress or the felling or logging of trees, or the transport of timber by inland waters, or the control of extinguishing of forest fires; or

(xxiv) employed in operations for the catching or hunting of elephants or other wild animals; or

(xxv) employed as a driver; or

(xxvi) employed in the handling or transport of goods in, or within the precincts of,—

(a) any warehouse or other place in which goods are stored, and in which on any one day of the preceding twelve months ten or more persons have been so employed; or

(b) any market in which on any day of the preceding twelve months, fifty or more persons have been so employed; or

(xxvii) employed in any occupation involving the handling and manipulation of radium or X-rays apparatus, or contact with radio-active substances; or

(xxviii) employed in or in connection with the construction, erection, dismantling, operation or maintenance of an aircraft as defined in section 2 of the Indian Aircraft Act, 1934; or

(xxix) employed in farming by tractors or other contrivances driven by steam or other mechanical power or by electricity; or

(xxx) employed, otherwise than in a clerical capacity, in the construction, working, repair or maintenance of a tube-well; or

(xxxi) employed in the maintenance, repair or renewal of electric fittings in any building; or

(xxxii) employed in a circus.

Explanation—In this Schedule, “the preceding twelve months” relate in any particular case to the twelve months ending with the day on which the accident in which case occurred.

Amount of Compensation

The scale of compensation is given clearly in Schedule IV which is given below—

SCHEDULE IV

(See Section 4)

COMPENSATION PAYABLE IN CERTAIN CASES

Monthly wages of the workman injured		Amount for Compensation for		Half-monthly payment as compensation for temporary disablement
		Death	Permanent total disablement	
1		2	3	4
More than	But not more than			
Rs	Rs	Rs	Rs	Rs nP Half his monthly wages
0	60	7,200	10,080	
60	90	9,000	14,608	36 00
90	120	11,520	16,128	42.00
120	150	13,500	18,900	48.75
150	200	16,800	23,520	60.00
200	300	18,000	25,200	82.50
300	400	19,200	26,880	100 00
400	500	21,000	29,400	118.75
500	600	21,600	30,240	135.00
600	700	23,100	32,340	148.75
700	800	24,000	33,600	160.00
800	900	27,000	37,800	168.75
900	1,000	30,000	42,000	175.00

Column 1 shows the scale of monthly wages according to which compensation is payable at rates mentioned in column 2 in case *death results* from the injury, and at rates given in column 3 where the injury results in *permanent total disablement*. *Total disablement* is defined by section 2 (1) to mean—

“Such disablement, whether of a temporary or permanent nature, as incapacitates a workman for all work which he was capable of performing at the time of the accident resulting in such disablement: Provided that permanent total disablement shall be deemed to result from every injury specified in Part I of Schedule I or from any combination of injuries specified in Part II thereof where the aggregate

percentage of the loss of earning capacity, as specified in the said Part II against those injuries, amounts to one hundred per cent, or more" [S. 2 (1)].

Injuries deemed to result in *permanent total disablement* are listed in Part I of Schedule I of the Act—

SCHEDULE I

[See Sections 2(1) and 4]

PART I

LIST OF INJURIES DEEMED TO RESULT IN PERMANENT TOTAL DISABLEMENT

Serial No.	Description of injury	Percentage of loss of earning capacity
1.	Loss of both hands or amputation at higher sites ...	100
2.	Loss of a hand and a foot ...	100
3.	Double amputation through leg or thigh, or amputation through leg or thigh on one side and loss of other foot ...	100
4.	Loss of sight to such an extent as to render the claimant unable to perform any work for which eyesight is essential ...	100
5.	Very severe facial disfigurement ...	100
6.	Absolute deafness ...	100

If the *permanent disablement* is not total but *partial*, the following table is laid down in Schedule, I Part II to the Act—

SCHEDULE I

PART II

LIST OF INJURIES DEEMED TO RESULT IN PERMANENT PARTIAL DISABLEMENT

Serial No.	Description of injury	Percentage of loss of earning capacity
<i>Amputation cases—upper limbs (either arm)</i>		
1.	Amputation through shoulder joint ...	90
2.	Amputation below shoulder with stump less than 8" from tip of acromion ...	80
3.	Amputation from 8" from tip of acromion to less than 4½" below tip of olecranon ...	70

Serial No.	Description of injury	Percentage of loss of earning capacity
4.	Loss of a hand or of the thumb and four fingers of one hand or amputation from $4\frac{1}{2}$ " below tip of olecranon	60
5.	Loss of thumb	30
6.	Loss of thumb and its metacarpal bone	40
7.	Loss of four fingers of one hand	50
8.	Loss of three fingers of one hand	30
9.	Loss of two fingers of one hand	20
10.	Loss of terminal phalanx of thumb	20
<i>Amputation cases — lower limbs</i>		
11.	Amputation of both feet resulting in end-bearing stumps	90
12.	Amputation through both feet proximal to the metatarso-phalangeal joint	80
13.	Loss of all toes of both feet through the metatarso-phalangeal joint	40
14.	Loss of all toes of both feet proximal to the proximal inter-phalangeal joint	30
15.	Loss of all toes of both distal to the proximal inter-phalangeal joint	20
16.	Amputation at hip	90
17.	Amputation below hip with stump not exceeding 5" in length measured from tip of great trochanter	80
18.	Amputation below hip with stump exceeding 5" in length measured from tip of great trochanter but not beyond middle thigh	70
19.	Amputation below middle thigh to $3\frac{1}{2}$ " below knee	60
20.	Amputation below knee with stump exceeding $3\frac{1}{2}$ " but not exceeding 5"	50
21.	Amputation below knee with stump exceeding 5"	40
22.	Amputation of one foot resulting in end-bearing	30
23.	Amputation through one foot proximal to the metatarso-phalangeal joint	30
24.	Loss of all toes of one foot through the metatarso-phalangeal joint	20
<i>Other injuries</i>		
25.	Loss of one eye, without complications, the other normal	40

Serial No.	Description of injury	Percentage of loss of earning capacity
26.	Loss of vision of one eye without complication or disfigurement of eye-ball, the other being normal ...	30
	<i>Loss of—</i>	
	<i>A — Fingers of right or left hand</i>	
	<i>Index finger</i>	
27.	Whole ...	15
28.	Two phalanges ...	11
29.	One phalanx ...	9
30.	Guillotine amputation of tip without loss of bone	5
	<i>Middle finger</i>	
31.	Whole ...	12
32.	Two phalanges ...	9
33.	One phalanx ...	7
34.	Guillotine amputation of tip without loss of bone	4
	<i>Ring or little finger</i>	
35.	Whole ...	7
36.	Two phalanges ...	6
37.	One phalanx ...	5
38.	Guillotine amputation of tip without loss of bone	2
	<i>B — Toes of right or left foot</i>	
	<i>Great toe</i>	
39.	Through metatarso-phalangeal joint ...	14
40.	Part, with some loss of bone ...	3
	<i>Any other toe</i>	
41.	Through metatarso-phalangeal joint ...	3
42.	Part, with some loss of bone ...	1
	<i>Two toes of one foot, excluding great toe</i>	
43.	Through metatarso-phalangeal joint ...	5
44.	Part, with some loss of bone ...	2
	<i>Three toes of one foot, excluding great toe</i>	
45.	Through metatarso-phalangeal joint ...	6
46.	Part, with some loss of bone ...	3
	<i>Four toes of one foot, excluding great toe</i>	
47.	Through metatarso-phalangeal joint ...	9
48.	Part with some loss of bone ...	3

NOTE: Complete and permanent loss of the use of any limb or member referred to in Schedule I shall be deemed to be the equivalent of the loss of that limb or member.

Partial disablement is defined by section 2 (g) to mean—

“where the disablement is of a temporary nature, such disablement as reduces the earning capacity of a workman in any employment in which he was engaged at the time of the accident resulting in the disablement, and where the disablement is of a permanent nature, such disablement as reduces his earning capacity in every employment which he was capable of undertaking at that time: Provided that every injury specified in Part II of Schedule I shall be deemed to result in permanent partial disablement”.

In case of *temporary disablement, total or partial*, section 4 (i) requires a half monthly payment to be made on the sixteenth day from the date of the disablement, if the disablement lasts a period of 28 days or more or after the expiry of a waiting period of three days from the date of disablement where the disablement lasts for a period of less than 28 days and thereafter half-monthly during the disablement or during a period of five years, whichever period is shorter. This payment is at the rate as shown in column 4 of Schedule IV a sum, equal to one half of his monthly wages, not exceeding Rs 30. It should be noted that any payment or allowance by way of compensation, but not for medical treatment, which the workman may have already received from the employer during the period of disablement should be deducted and that no half-monthly payment should exceed the amount by which half the amount of the monthly wages of the workman before the accident exceeds half the amount of such wages which he is earning after the accident proviso to S. (4) (1)].

A new section, 4A, has been added by the Amendment Act of 1959 to the effect that *compensation must be paid as soon as it falls due*, but that if the employer does not accept liability to the extent claimed he must make provisional payment to the extent accepted by him either by depositing it with the Commissioner or made to the workman. A *penalty* for non-payment within one month is also laid down by the same section.

Wages—The term “*wages*” is defined by section 2(m) as including any privilege or benefit which is capable of being estimated in money; other than a travelling concession or a contribution paid by the employer or a workman towards any pension or provident fund or a sum paid to a workman to cover any special expenses entailed on him by the nature of his employment.

Monthly wages means according to section 5, the amount of wages deemed to be payable for a month's service (whether the wages are payable by month or by whatever other period or at piece rates) and *calculated as follows*, namely—

(a) where the workman has, during a continuous period of not less than twelve months immediately preceding the accident, been in the service of the employer who is liable to pay compensation, the monthly wages of the workman

shall be one-twelfth of the total, wages which have fallen due for payment to him by the employer in the last twelve months of that period;

(b) where the whole of the continuous period of service immediately preceding the accident during which the workman was in the service of the employer who is liable to pay the compensation was less than one month, the monthly wages of the workman shall be the average monthly amount which during the twelve months immediately preceding the accident, was being earned by a workman employed on the same work by the same employer, or if there was no workman so employed, by a workman employed on similar work in the same locality;

(c) in other cases, (including cases in which it is not possible for want of necessary information to calculate the monthly wages under Clause (b) the monthly wages shall be thirty times the total wages earned in respect of the last continuous period of service immediately preceding the accident from the employer who is liable to pay compensation, divided by the number of days comprising such period.

Explanation—A period of service shall, for the purposes of this section be deemed to be continuous which has not been interrupted by a period of absence from work exceeding fourteen days.

Distribution of Compensation

The Act provides that compensation payable in respect of a workman whose injury has resulted in death, or compensation payable as a lump sum to a woman or person under a legal disability, must be deposited with the Commissioner and should not be paid directly by the employer. The employer is, however, permitted to make advances to any dependent on account of compensation payable in the case of a deceased workman provided the amount so paid does not exceed an aggregate of Rs 100. The employer is also permitted to deposit with the Commissioner any amounts payable as compensation which are not less than Rs 10. The receipt given by the Commissioner for such deposit shall be a sufficient discharge for payment of such compensation. Out of the money deposited with the Commissioner as compensation in respect of a deceased workman, the Commissioner must deduct the actual cost of the workman's funeral expenses not exceeding Rs 50 and pay this amount to the person who has borne such expenses. The compensation deposited in case of a deceased workman should be apportioned among the dependents of such deceased workman in such proportion as the Commissioner thinks fit. If, however, the amount is to be payable to a woman or a person under legal disability the same may be invested or otherwise dealt with for the benefit of such woman or person under disability (S.8). *Compensation payable under this Act either in a lump sum or by a half monthly payment cannot be assigned, attached or charged* [S.9].

*The Commissioner must be given notice of the accident as soon as practicable after the happening of the event and the proceedings should then be commenced within two years of the occurrence of the accident, or, in case of death, within two years from the date of death. However, the Commissioner may entertain and decide any case even though notice has not been given or the claim is not made in due time if he is satisfied that such failure was due to sufficient cause. In case the accident has resulted in contracting a disease, it shall have been taken to have occurred on the first of the days during which the workman was continuously absent [S. 10]. In case of partial disablement due to contracting of any such disease and which does not force the workman to absent himself from work, the two years period is to be counted from the day the workman gives notice of disablement to his employer. It has been held that *incapacity for work means* loss or diminution of the wage earning capacity and includes inability to get work as a result of the injury which the workman has sustained.¹⁰*

Commissioners

We have seen that the Commissioners play an important part in connection with the working of this Act, *These Commissioners are appointed by the State Government by notification in the Official Gazette and are deemed to be public servants. These are the officers before whom in default of an agreement, all proceedings under this Act on the question of liability for compensation including the question as to whether the person injured was a workman have to be referred. No Civil Court has jurisdiction to settle, decide or deal with these questions which are thus brought under the jurisdiction of the Commissioner. Of course, the Commissioner to be referred to is the Commissioner for the local area in which the accident takes place [Sec. 19, 20 & 21]. The act aims at an amicable settlement if possible between the employer and the workman and the application therefore has not to be made to the Commissioner unless and until the question at issue is one on which they have been unable to settle by agreement. The Commissioner is given all the powers of a Civil Court under the Code of Civil Procedure, 1908, for the purpose of taking evidence on oath and of enforcing the attendance of witnesses and compelling production of documents. A brief memorandum of the substance of the evidence of every witness has to be made by the Commissioner. He may, if he thinks fit submit any question of law for decision to the High Court [Secs. 23, 25 and 27]. If, however, the*

¹⁰ *Balt v. Hunt & Sons Ltd.* (1912), A. C. 496.

parties have come to a settlement the memorandum thereof is to be sent by the employer to the Commissioner, who on being satisfied as to its genuineness records it in a register kept for the purpose [S. 28].

Appeals

There is an appeal within sixty days to the High Court from the following orders of the Commissioner—

(1) an order awarding as compensation a lump sum whether by way of redemption of a half-monthly payment or otherwise or disallowing a claim in full or in part for a lump sum;

(2) an order refusing to allow redemption of a half-monthly payment;

(3) an order providing for the distribution of compensation among the dependents of a deceased workman, or disallowing any claim of a person alleging himself to be such dependent;

(4) an order allowing or disallowing any claim for the amount of an indemnity under the provisions of sub-section (2) of section 12; or

(5) an order refusing to register a memorandum of agreement or registering the same or providing for the registration of the same subject to conditions.

No appeal will lie in any case in which the parties have agreed to abide by the decision of the Commissioner, or in which the order of the Commissioner gives effect to an agreement come to by the parties. Besides, an appeal will not lie against an order unless a substantial question of law is involved and in case of orders [except under (2) above] unless the amount in dispute is not less than Rs 300. An appeal by the employer under (1) above will not lie unless the memorandum of appeal is accompanied by a certificate by the Commissioner that the appellant has deposited with him the amount payable under the order appealed against [S. 30].

QUESTIONS

1. What method is laid down in the Workmen's Compensation Act for calculating monthly wages of a workman?

2. Discuss briefly the liability of an employer for the payment of compensation, and state the amount of compensation payable on (a) death and (b) partial disability.

3. During the course of proceedings under the Workmen's Compensation Act the parties to the dispute arrive at an amicable agreement, and ask the Commissioner to record it and to pass a decree in terms thereof. Can he do so?

What are the circumstances under which a workman can sue his employer under the Workmen's Compensation Act?

4. What are the discretionary powers given to the Commissioner under the Workmen's Compensation Act regarding distribution of compensation amongst the descendants of a deceased workman, and from what order of the Commissioner will an appeal lie and where?

5. What defences are available to an employer against a claim under the Workmen's Compensation Act for compensation made by a workman in the employment?

6. In what different industries and occupations are workmen entitled to receive compensation under the Workmen's Compensation Act?

7. (a) Explain fully the expression 'arising out of and in the course of employment' as used in Section 3 of the Workmen's Compensation Act, 1923.

(b) Explain the provisions of the Workmen's Compensation Act relating to distribution of compensation.

8. (a) 'No claim for compensation shall be entertained by a Commissioner' unless notice of the accident has been given in the proper manner. Explain with reference to Workmen's Compensation Act.

(b) Is the order of the Commissioner under the Workmen's Compensation Act, 1923, appealable? If so, where and under what circumstances?

9. When is an employer (i) liable, (ii) not liable, to pay compensation for personal injury to a workman?

10. Discuss fully "personal injury caused by accident arising out of and in the course of employment."

11. Enumerate the exceptions to the employer's liability for compensation under the Workmen's Compensation Act.

Chapter 39

THE EMPLOYEES' PROVIDENT FUNDS ACT, 1952

THE EMPLOYEES' Provident Funds Act is one more piece of social insurance legislation in India and provides for the institution of compulsory provident fund for employees in factories. Its object is to make some provision for the distant future of the industrial worker so that he is not put to unnecessary hardship after retirement. The Act came into force on November 1, 1952.

Extent of Application

It extends to the whole of India except Jammu and Kashmir and applied in the first instance to factories employing 50 or more persons and which have completed 3 years of their existence. The Act was subsequently amended and now factories employing 20 or more persons are covered but the Act will not apply until the expiry of 5 years from the date of their establishment. The Act was initially made applicable to only six scheduled industries, namely, cement; cigarette; electrical; mechanical or general engineering products; iron and steel; paper and textiles (cotton, silk and jute). Subsequently, the scope of the scheme was extended to many more industries. The Act was amended in 1958, 1960, 1962, 1963 and 1965

with a view to enlarge its coverage. The consequences of the amendment *inter alia* are—

(1) The Act which was hitherto applicable to establishments employing 50 or more persons will now cover establishments employing 20 or more persons.

(2) An establishment once covered under the Act will continue to be so covered despite reduction in employment strength below 20 except where the number of persons employed is reduced to less than 15 and remains so for a continuous period of not less than one year.

(3) Different departments of an establishment will be treated as parts of the same establishment.¹

(4) Retaining allowance received by the employees will be taken into account for purposes of calculating contributions.

(5) Establishments employing 20 or more persons but less than 50 will not attract the provisions of the Act until the expiry of 5 years from the date of their establishment, and in case of establishments employing 50 or more persons the exemption is for 3 years.

(6) Establishments registered under the Co-operative Societies Act employing less than 50 persons and working without the aid of power will not be covered under the Act.

(7) Central Government may, having regard to the financial position of any class of establishments, exempt that class of establishments from the operation of this Act for such period as may be specified in the notification.

(8) Raising the wage limit for eligibility to become members of the provident fund to be Rs 1,000 per month.

(9) Extension of the benefits of the Act to employees employed by or through a contractor in connection with the work of the establishment covered under the Act and enabling the employer to recover the contribution from the contractor.

The Act and the Scheme cannot be applied retrospectively to any establishment.² Any demand for provident fund contribution for a back period is not merely illogical and oppressive but plainly inconsistent with the terms of the enactment.³

¹ *Delhi Cloth and General Mills Co. Ltd. v. Regional Provident Fund Commissioner*—1961 II-L. L. J. 444

² *See Evershine Metals and another v. Regional Provident Fund Commissioner*—1962-II L. L. J. 479

³ *K. R. Subbler v. Regional Provident Fund Commissioner*—XXIII F. J. R.

The date of establishment of a factory under the Act means the date when the manufacturing process started and a change of ownership would not start a fresh date of establishment of a factory.⁴

Tests for Determining the Applicability of the Act

1. The word "factory" in Sec. 1 (3) (a) is comprehensive so as to cover not only factories exclusively engaged in any scheduled industry, but also composite factories in industries some of which fall within the schedule and some do not. The test for determining whether or not the Act applies to such a composite factory is whether its activity which falls within the schedule is its primary and dominant activity or only its incidental or feeder activity. In the former case, the whole factory is within the purview of the Act, and in the latter case not.

The requirements as to the number of persons employed applies to "factory" and not to "industry", and so if the composite factory employs the prescribed number of persons, the Act applies to it, even though the unit engaged in the scheduled industry may be employing less than the prescribed.⁵

2. If one of the several industries carried on in one premises is a primary and dominant industry and the other industries are minor or subsidiary industries which are only feeders of the main industry, it is the character of the main industry which determines whether or not the Act would apply, depending upon whether the main industry falls or does not fall within Schedule I of the Act.

But if the several industries which are being run on one premises are independent and separate industries, the question as to which is dominant and which is feeder does not arise, and in such a case, if any one of the industries fall within Schedule I, the provisions of the Act will apply to the entire factory. In such a case, the requirement as to the minimum number of employees applies to the establishment as a whole and not to each separate activity carried on in the premises.⁶

3. Section 1 (3) (b) which confers on the Central Government the power to extend the application of the Act to new establishments

⁴ *Rabindranath Textile Mills v. Secretary, Ministry of Labour, Government of India, and another.*

⁵ *Regional Provident Fund Commissioner, Bombay v. Shree Krishna Metal Mfg. Co., Bhandra*, 1962, I. L. L. J. 427

⁶ *Associated Industries Pvt. Ltd., v. Regional Provident Fund Commissioner, Kerala* 1963, 2 L. L. J. 652

by adding them to the schedule is valid and constitutional. It does not delegate uncontrolled legislative power to the executive, nor does it suffer from the vice of discrimination.⁷

Rate of Contributions

The employer's contribution to the fund has been fixed as 6½ per cent of the basic wages and dearness allowance and retaining allowance, if any, for the time being payable to each of the employees. The employee's contribution is equal to that of the employers. It is, however, open to an employee to contribute up to 8½ per cent of his basic wages plus dearness allowance plus retaining allowance. Retaining allowance means, an allowance payable for the time being to an employee of any factory or other establishment during any period in which the establishment is not working for retaining his services. With effect from January 1, 1963, the statutory rate of provident fund contribution has been raised to 8 per cent in establishments employing 50 or more persons engaged in (i) Cigarettes; (ii) Electrical, Mechanical and General Engineering Product, (iii) Iron & Steel, (iv) Paper (other than hand made paper) and (v) Cement (with effect from 1st April, 1953).

From time to time number of industries were brought under the purview of enhanced rate of provident fund contribution and the establishments thus covered are, *viz.* 1. Textiles (made wholly or in part of artificial silk and wool); 2. Matches; 3. Edible Oils & fats, other than Vanaspati; 4. Rubber and rubber products; 5. Electricity including the generation, transmission and distribution thereof; 6. Tea; 7 Printing other than printing industry relating to newspaper establishments as defined in the Working Journalists (conditions of Service) and Miscellaneous Provisions Act, 1955]. including the process of composing types for printing, printing by letter process lithography, photogravure or other similar process of book binding; 8. Glass; 9. Stone-ware pipes; 10. Sanitary wares; 11. Electrical porcelain insulators of high and low tension; 12. Refractories; 13. Tiles; 14. Heavy and fine chemicals, including the following: fertilizers Turpentine, Rosin, Medical and Pharmaceutical preparations, toilet preparations, soaps, inks, intermediates, dyes, colour lakes and towers, fatty acids, and oxygen, acetylene and carbon-dioxide gases; 15. Indigo; 16. Non-edible animal oils and fats; 17. Mineral Oil refining industry and 18. Newspaper establishments; 19. Sugar; 20. Lac including shellac; 21. Industrial and Power Alcohol industry; 22. Asbestos Cement Sheets industry; 23. Biscuit making industry

⁷ *Mohmedali and others v. Union of India*, 1963, I. L. L. J. 536

Including composite units making biscuits and products such as bread, confectionery and milk and milk powder; 24. Mica industry; 25. Plywood industry; 26. Automobile repairing and servicing industry; 27. Rice milling; 28. Flour milling; 29. Dal milling; 30. Starch industry; 31. Petroleum or natural gas exploration, prospecting, drilling or production; 32. Petroleum or natural gas refining; 33. Leather and leather products industry; 34. Stone-ware jars; 35. Crockery; 36. The fruit and vegetable preservation industry, that is, any industry which is engaged in the preparation or production of any of connected articles; 37. Cashewnut industry; 38. Confectionery industry. 39. Buttons; 40. Brushes; 41. Plastic and plastic products; 42. Stationery products; 43. Aerated water, soft drinks or carbonated water; 44. Distilling and rectifying or spirits (not falling under industrial and power alcohol) and blending of spirits industry; 44. Paint and varnish industry; 45. Bone crushing industry; 46. Pickers industry; 47. Milk and milk products industry; 48. Employees of non-ferrous metals and alloys in the form of ingots industry; 49. Bread industry; 50. Stemming or redrying of tobacco leaf industry, that is to say, any industry engaged in the stemming, re-drying, handling, sorting, grading or packing of tobacco leaf; 51. Agarbatti (including dhoop and dhoop-batti) industry; 52. Coir (excluding the spinning sector) industry.

Protection against Attachment

The Act provides that the amount standing to the credit of any member in the fund shall not in any way be capable of being assigned or charged and shall not be liable to attachment under any decree or order of any Court in respect of any debt or liability incurred by the member. No employer can by reason only of his liability for the payment of any contribution to the fund reduce directly or indirectly the wages of any employee to whom the scheme applies or the total quantum of benefit in the nature of old age pension, gratuity or provident fund to which the employee is entitled under the terms of his employment.

Who Can be a Member

Every employee employed in or in connection with the work of a factory or other establishment to which this Act applies and whose emoluments do not exceed Rs 1,600 per month shall be entitled and required to become a member of the Fund from the beginning of the month following that in which he has completed six months' continuous service or has actually worked for not less than

120 days within a period of six months or less in that factory or other establishment or in any other factory or other establishment to which the Act applies under the same employer or partly in one and partly in the other or has been declared permanent in any such factory or other establishment whichever is the earliest. A person who had been totally incapacitated for work in a particular establishment and had withdrawn his accumulation in full can now become a member of the Fund on subsequent employment in any establishment mentioned in the schedule to the Act.

Administration Charges

The central government may in consultation with the central board and having regard to the resources of the Fund available for meeting its normal administration expenses fix the percentage of administrative charges on the pay namely, basic wages, dearness allowance, retaining allowance and cash value of the food concession admissible thereon of the employee.

THE EMPLOYEES' FAMILY PENSION SCHEME 1971

The Scheme

The scheme was introduced by the Central Government in exercise of the powers conferred on it under section 6A of the Provident Funds Act. It applies to all establishments covered by the Act except those which have a pension scheme on a scale which is not less favourable than those provided under this scheme.

The scheme is an important social security measure and is intended to provide protection to the families of industrial workers who may be rendered destitute because of death or retirement of the earning member. The scheme is independent of all other social security legislations and therefore the benefits available are only in addition to the benefits available under other enactments.

Employees of all factories and other establishments covered under the Employees' Provident Fund and Family Pension Fund Act 1952 are covered by the scheme and are obliged to become members of the scheme. A member of the Family Pension Scheme will continue to be so until he attains the age of 60 years or until he retires or quits the service and withdraws or becomes entitled to withdraw the benefits to which he is eligible under the scheme or dies during the period of reckonable service, whichever is the earliest.

The family pension will be paid from the beginning of the month immediately following the month in which a member of the scheme dies. The pension is payable to the widow or widower up to the date of death or remarriage whichever is earlier failing which to the eldest surviving minor son until he attains the age of 18 and failing both to the eldest surviving unmarried daughter until she attains the age of 21 or marries, whichever is earlier. The pension amount ranges from Rs 40 to Rs 150 per month, the actual amount depending upon the pay of the particular member at death and the age of his entry into the scheme.

Besides family pension, the scheme also provides for Life Assurance and Retirement Benefits. Where a member of the Family Pension Fund who had entered the scheme at the age of 25 or below dies while in service a lumpsum of Rs 1,000 will be payable to his family as Life Assurance benefit. If, however, the member in question had joined the Scheme after the age of 25 years his family will be eligible for the aforesaid amount of Life Assurance Benefit multiplied by a factor depending on the age at entry given in the scheme.

Where a member attains the age of 60 years and had entered the Fund at the age of 25 years or less and contributed to the Fund for not less than two years, he will be paid a lump sum of Rs 4,000. If, however, he had entered the Fund after he was 25 years of age, he will be eligible to the aforesaid sum of Rs 4,000 multiplied by a factor, depending on the age of entry given in the scheme.

Where a member dies before the aforesaid amount is actually paid to him, the lump sum shall be payable to the member of the family who is entitled for the family pension under the scheme. In the event of cessation of membership from the Family Pension Fund before completions of two years' contribution to the Fund, the contributions of the member together with interest at $5\frac{1}{2}$ per cent will be refunded to him.

Meeting the Cost of Benefit Payable under the Scheme

The existing procedure for payment of the Employees' Provident Fund contribution will apply in the case of contribution to the Family Pension Fund also. From out of the contributions paid by the employee and the employer to the Employees' Provident Fund every month, a part of the contributions representing $1\frac{1}{6}$ th per cent of the employees' pay along with an equivalent amount of $1\frac{1}{6}$ th per cent from out of the Employer's contribution shall be credited

to the Family Pension Fund. The Central Government shall also contribute at the rate of $1\frac{1}{8}$ th per cent of the employees' pay and credit it to the said fund. These funds will remain in deposit with the central government in the family pension-cum-life assurance fund maintained in the public account of the government of India and the government will pay interest thereon at the minimum rate of $5\frac{1}{2}$ per cent per annum and this amount of interest also will be credited to the said fund in the public account. It is out of the funds in this account that the benefits of the Family Pension Scheme would be met.

Administration of the Scheme

The Central Board of Trustees of the Employees' Provident Fund, a tripartite body, will administer the scheme through its chief executive officer *i.e.* the Central Provident Fund Commissioner and the 15 Regional Provident Fund Commissioners functioning under his control in the Regional offices.

THE MATERNITY BENEFIT ACT, 1961

This is a Central Act. It extends to the whole of India. It applies in the first instance to factories, mines and plantations. Other establishments may be brought within its purview by notification. It is not applicable to establishments covered by the Employees' State Insurance Act. But the benefit already enjoyed by a woman employee will continue to be available to her under this Act till she becomes qualified to receive the same under the Employees' State Insurance Act. Similarly a woman employee who becomes not entitled to the benefit under Employees' State Insurance Act but still being eligible under this Act will continue to receive the same.

Every woman shall be entitled to and her employer shall be liable for the payment of maternity benefit at the rate of the average daily wage for the period of her actual absence. The maximum period for which any woman will be entitled to maternity benefit shall be twelve weeks, that is to say six weeks up to and inclusive of the day of her delivery and six weeks immediately following that day. In the event of her death during the period the benefit will be available only till the date of her death. But if after delivery she dies leaving a child it will be available for six weeks from the date of delivery.

No woman shall be entitled to maternity benefit unless she has actually worked in an establishment of the employer from whom

she claims maternity benefit for a period not less than one hundred and sixty days in the twelve months immediately preceding the date of her expected delivery. But for the purpose of calculation under this provision the number of days she has been laid off in the preceding twelve months shall not be taken into account.

The Act also prohibits employment of a woman for six weeks from the date of delivery or miscarriage. A pregnant woman should also on a request from her be not given work which is of arduous nature or which involves long hours of standing or which in any way is likely to interfere with her pregnancy or the normal development of the foetus or is likely to cause miscarriage or to otherwise adversely affect her health in a period of one month preceding the six weeks of the date of delivery or during the six weeks if she has not availed herself of leaves.

The benefit for the period prior to delivery shall be payable on proof of pregnancy and for the subsequent period within forty-eight hours on proof of delivery. In the event of the death of the woman, the benefit shall be payable to her nominee or legal representative. In cases where no pre-natal confinement and post-natal care is provided by the employer, a woman entitled to medical benefit shall also be entitled to a medical bonus of twenty five rupees.

For miscarriage, a woman shall be entitled to leave with wages at the rate of maternity for a period of six weeks from the date of miscarriage. For illness arising out of pregnancy, delivery, premature birth of a child or miscarriage, an additional one month's leave with wages shall also be allowed. After return from leave and on joining duty and until the child attains fifteen months of age, the woman shall be allowed two additional breaks for nursing the child.

In accordance with the provisions of the Act a woman shall not be punishable with dismissal or discharge for absence due to pregnancy. Dismissal or discharge during the pregnancy of a woman entitled to maternity benefit otherwise shall not have the effect of denying her that benefit. But for gross misdeed such a dismissal will entail her losing the benefit. But she should be advised to that effect in writing. She has a right to appeal against that order to the appropriate authority.

Change in the nature of work of a pregnant woman or her being allowed additional nursing intervals should not entail deduction in her wages.

The Act constitutes inspectors who ensure that the provisions of the Act are complied with. Contravention of the provisions is made penal. A woman in receipt of a benefit under this Act will forfeit it if found working in any other establishment during the period of absence from her employer's place.

Chapter 40

THE PAYMENT OF GRATUITY ACT, 1972

THE GRATUITY in its old-day concept was merely a gift made by the employer in his own discretion. At one time it was treated as payment gratuitously made by the employer to the employee at his pleasure. But as a result of a long line of decisions, gratuity has now come to be regarded as a legitimate claim which workmen can make and which, in a proper case, can give rise to an industrial dispute. In industrial law it has come to mean some sort of retirement benefit which is available to an employee for long and continuous service. In other words, gratuity paid to workmen is intended to help them after retirement whether the retirement is the result of rules of superannuation or physical disability or otherwise. The general principle underlying such gratuity scheme is that by virtue of the length of their service, workmen are entitled to claim a certain amount as a retiral benefit. It is not paid to an employee gratuitously or merely as a matter of boon; it is paid to him for long and meritorious service rendered by him to the employer.

Gratuity and Provident Fund

In 1952, the Union Government enacted the Employees Provident Fund Act, intended to afford the employees some sort of retirement benefit. Contributing to the Provident Fund is design-

to induce thrift so that the employee may lay by from his present earnings a portion for his old age. As the workman cannot be expected to spare much, considering the gap between what he earns and what he must spend, the employer is expected to make a contribution. After the enforcement of this Act employers challenged the right to gratuity recognised by industrial adjudication on the ground that the Provident Fund Act sufficiently takes care of the retirement benefit and therefore, there is no further need of awarding gratuity to the workmen.

The Supreme Court in *Wenger & Co. v. Its Workmen*¹ observed as follows—

“Provident Fund is a lump-sum payment as a retiral benefit after superannuation or on termination of service for recognised reasons. Gratuity, however, is a retiral benefit of a different kind from provident fund because it is earned only by rendering service. The object intended to be achieved by a provident fund scheme is not the same as the object of a gratuity scheme.”

It is, therefore, now well established that a scheme of gratuity can be introduced in concerns where there already exist other schemes such as provident fund or retirement compensation. Though provident fund and gratuity are benefits available at retirement, they are not the same and one exist without the other. In other words, they can all exist together provided the financial position of the employer justifies such a course.

Gratuity and Retrenchment Compensation

Prior to the enactment of S. 25-F of the Industrial Disputes Act industrial awards had been giving the benefit of both retrenchment compensation and gratuity to workmen, subject to the capacity of the employer to pay. In other words, both these claims were recognised by industrial adjudication and they were on par in status, that is to say, neither of them was codified. But after the enactment of S. 25-F of the Industrial Disputes Act it was contended on behalf of the employer that in view of this enactment it is unnecessary to award gratuity because retirement compensation has been provided for under the provisions of the statute to the retrenched workmen. It was contended that this itself is in the nature of gratuity and, therefore, any other gratuity should not be given.

The Supreme Court, it appears, took quite a practical view of the matter and found that when before the enactment of 25-F if both

¹ (1963), II L. L. J. 403 (413)

the claims were being granted, there is no reason why it should not continue to be so after the enactment of the said S. 25-F. While doing so, the Supreme Court has drawn a distinction between the two claims on the basis that gratuity is necessary to be paid at the time of retirement or a physical disability or death or even resignation after a long service. It is, in substance, a retirement benefit. But that is not a case with the retrenchment compensation.

As to the character of retrenchment compensation the Supreme Court observes—

“On the other hand, the retrenchment compensation, is not a retirement benefit at all. As the expression “retrenchment compensation” indicates it is compensation paid to a workman on his retrenchment and it is intended to give him some relief and to soften the rigour of hardships which retrenchment inevitably causes. The retrenched workman is, suddenly and without his fault, thrown out on the street and has to face the grim problem of unemployment. At the commencement of his employment, a workman naturally expects and looks forward to security of service spread over a long period, but retrenchment destroys these hopes and expectations. The object of retrenchment compensation is to give partial protection to the retrenched employee and his family to enable him to tide over the hard period of unemployment. Thus the concept on which grant of retrenchment compensation is based, is essentially different from the concept on which gratuity is founded.”

Relevant Factors for Framing Gratuity Scheme

In *Bharatkhand Textile Manufacturing Co. Ltd. v. Textile Labour Association, Ahmedabad*² the Supreme Court indicated some material factors which have to be taken into consideration before framing a gratuity scheme—

- (i) financial capacity of the employer;
- (ii) his profit making capacity;
- (iii) the profits earned by him in the past;
- (iv) the extent of his reserves;
- (v) the chances of his replenishing them; and
- (vi) the claim for capital invested by him.

The court further observed that these are not exhaustive and there may be other material considerations which may have to be borne in mind in determining the terms and conditions of the gratuity

² 1960, II L.L.J., 21

scheme. The existence of other retiring benefits such as provident fund and retrenchment compensation or other benefits do not destroy the claim of gratuity—its quantum may, however, have to be adjusted in the light of the other benefit.

Financial Capacity of the Company

It is a very relevant factor and according to well settled law, only if, there is such a capacity the schemes are to be awarded for judging the financial position or the capacity to pay, the criteria are the same as those for wage revision. In the case of *Gramophone Company Ltd. v. Its workmen*,³ the Supreme Court has in terms observed as under—

“When an Industrial Tribunal is considering the question of wage structure and gratuity which in our opinion stands more or less on the same footing as wage structure it has to look at the profits made without considering the provisions for taxation for the shape of income tax and for reserves.”

Although the principles and criteria for judging the financial position or capacity to pay of the industry or concern have to be considered in the same way as in case of revision of wages, there is one marked and vital difference in calculating the burden of the award on the company. In case of wage revision, every workman has to be given the benefit of the same immediately and therefore the per capita burden has to be multiplied by the number of workmen. But in case of gratuity, no doubt, for every year of service, every workman has to be provided for at the rate that would be awarded, that is to say either 15 day or one month's wages per year or so on, but what is to be borne in mind is that all workmen do not retire at a time and, therefore, it is not a matter of immediate expense. It is generally found that hardly 3 to 4 per cent workmen retire and actually every year the concerns have to pay on account of gratuity only to the extent of 3 to 4 per cent workmen, although for their entire length of service. It has now been well settled that the burden for this purpose of awarding gratuity should be calculated on this practical basis and not on the national or theoretical basis and for every year provision for a total wage bill for all the workmen to that extent has to be made.

The Payment of Gratuity Act, 1972

Prior to the enactment of this Act, there was no central law to regulate the payment of Gratuity to industrial workers except the

³ 1964, II L.L.J. P. 131 (135)

Working Journalists (Condition of Service and Miscellaneous Provisions) Act, 1955. Under this Act, the gratuity was payable even to an employee who resigns after 3 years' service. This was set aside by the Supreme Court on the ground that it was an unreasonable restriction on trade for the reason that it is payable as reward for long and faithful service. Thereafter in 1970, the Kerala State entered legislation for payment of gratuity, namely The Kerala Industrial Employers Payment of Gratuity Act, 1970. This Act was made applicable to workers in factories, plantations, shop and establishments. The West Bengal State also promulgated an Ordinance on June 3, 1971, presenting a similar scheme on the lines of the Kerala enactment. This Act is known as The West Bengal Employees' Payment of Compulsory Gratuity Act, 1971. The present Central Act has been modelled broadly on the lines of the West Bengal and Kerala Gratuity Acts.

In the Statement of Objects and Reasons, it has been stated that since many State Governments have either enacted or are in the Process of enacting legislation in regard to payment of gratuity to industrial worker in their respective States, it has become expedient to have a Central Statute on the subject so as to ensure a uniformity with regard to payment of gratuity to the industrial workers all over the country.

The Bill of this progressive labour legislation as amended was passed by the Lok Sabha on August 3, 1972 and by the Rajya Sabha on August 7, 1972. After the assent of the President of India it has been placed on the statute Book and named The Payment of Gratuity Act, 1972.

According to S. 3 of the Act, it shall apply to—

- (a) every factory, mine, oilfield, plantation, port and railway company;
- (b) every shop or establishment within the meaning of any law for the time being in force in relation to shops and establishments in a State, in which ten or more persons are employed, or were employed, on any day of the preceding twelve months;
- (c) such other establishments or class of establishments, in which ten or more employees are employed, or were employed, on any day of the preceding twelve months, as the Central Government may, by notification, specify in this behalf.

Definitions

In this Act, unless the context otherwise requires, "Appropriate Government" means—

- (i) in relation to establishment—
 - (a) belonging to, or under the control of the Central Government;
 - (b) having branches in more than one State;
 - (c) of a factory belonging to or under the control of the Central Government;
 - (d) of a major port, mine, oilfield or railway company, the Central Government;
- (ii) in any other case, the State Government [S. 2(a)].

The term "continuous service" means uninterrupted service and includes service which is interrupted by sickness, accident, leave, lay-off, strike or a lock-out or cessation of work not due to any fault of the employee concerned whether such uninterrupted or interrupted service was rendered before or after the commencement of this Act.

Explanation 1: In the case of an employee who is not in uninterrupted service for one year, he shall be deemed to be in continuous service if he has been actually employed by an employer during the twelve months immediately preceding the year for not less than—

- (i) 190 days, if employed below the ground in a mine; or
- (ii) 240 days, in any other case, except when he is employed in a seasonal establishment.

Explanation II: An employee of a seasonal establishment shall be deemed to be in continuous service if he has actually worked for not less than 75 per cent of the number of days on which the establishment was in operation during the year [S. 2(c)]. Under the provision, for the purpose of calculating gratuity, on an employee's service shall not be deemed to have been interrupted even if he goes on an "illegal strike".

The word "employee" has been defined under S. 2 (c) of the Act as "any person (other than an apprentice) employed on wages not exceeding one thousand rupees per mensem, in any establishment, factory, mine, oilfield, plantation, port, railway company or shop to do any skilled, semi-skilled, or unskilled, manual, supervisory, technical or clerical work, whether the terms of such employment are express or implied, but does not include any such person who is employed in a managerial or administrative capacity or who holds

a civil post under the Central Government or State Government or who is subject to the Air Force Act, 1950⁴, the Army Act, 1950⁵ or the Navy Act, 1957⁶.

Explanation: In the case of an employee, who having been employed for a period of not less than five years on wages not exceeding one thousand rupees per mensem, is employed at any time thereafter on wages exceeding one thousand rupees per mensem, gratuity in respect of the period during which such employee was employed on wages not exceeding one thousand rupees per mensem, shall be determined on the basis of the wages received by him during that period.

The word "employer" is defined by the Act as meaning "in relation to any establishment, factory, mine, oilfield, plantation, port, railway company or shop—

- (i) belonging to or under the control of the Central Government or a State Government, a person or authority appointed by the appropriate Government for the supervision and control of employees, or where no person or authority has been so appointed, the head of the Ministry or the Department concerned;
- (ii) belonging to, or under the control of, any local authority, the person appointed by such authority for the supervision and control of employees or where no person has been so appointed, the chief executive officer of the local authority;
- (iii) in any other cases the person who, or the authority which, has the ultimate control over the affairs of the establishment, factory, mine, oilfield plantation, port, railway company or shop and where the said affairs are entrusted to any other person, whether called a manager, managing director or by any other name, such person" [S. 2 (f)].

The word "retirement" means termination of the services of employee other than on superannuation [S. 2 (g)].

The word "superannuation" in relation to an employee means—

- (i) the attainment by the employee of such age as is fixed in the contract or conditions of service as the age on the attainment of which the employee shall vacate the employer; and

⁴ 45 of 1950

⁵ 46 of 1950

⁶ 62 of 1957

(ii) in any other case, the attainment by the employee of the age of fiftyeight years [S. 2 (r)].

“Wages” means all emoluments which are earned by an employee while on duty or on leave in accordance with the terms and conditions of his employment and which are paid or are payable to him in cash and includes dearness allowance but does not include any bonus, commission, house rent allowance, overtime wages and any other allowance [Sec. 2 (s)].

By the insertion of this definition, the Act has taken a departure from the existing schemes in as much as gratuity is payable under the Act not only on basic wages, but also on dearness allowance.

Payment of Gratuity [S. 4]

The Act provides for payment of gratuity by the employer to an employee on the termination of his employment after he has rendered continuous service for not less than five years. The restriction is not applicable in cases of death or termination of services because of any disablement due to accident or disease. For the purposes of computing the gratuity payable to an employee, who is employed after his disablement on reduced wages, his wages preceding his disablement will be taken to be the wages received by him during that period and for the period subsequent to his disablement on the basis of the wages so reduced.

Gratuity is payable at the rate of 15 days' wages (basic wage plus dearness allowance) for every completed year of service only. The ceiling has been raised to 20 months' wages so as to provide an incentive to employees to work beyond thirty years of service.

In the case of seasonal establishments, gratuity shall be paid at a lower rate *i.e.* 7 days' wages for each season. Employees of such establishments would be deemed to be on continuous service, if they had been employed for 75 per cent of the days during which the establishment has been working during the season.

The Act also protects any better or higher rights already earned by the employees under any award or settlement or agreement or contract with the employer.

S. 4 (b) deals with forfeiture of gratuity where the delinquent employee indulges in riotous conduct or if he is charged for misconduct or for an offence involving moral turpitude.

To what extent should gratuity be made payable to an employee, who is dismissed for misconduct not involving financial loss to the

management and for misconduct involving financial loss to the management? It is interesting to note the observations of the Supreme Court in *Delhi Cloth and General Mills Company Ltd. v. Its Workmen*.⁷

“A distinction should be made between technical misconduct which leaves no trace of indiscipline and misconduct resulting in damage to the employers’ property which may be compensated by forfeiture of gratuity or part thereof. A misconduct which does not directly cause any damage, such as an act of violence against management or other riotous or disorderly behaviour at or near the place of employment is conducive to grave indiscipline.

The first type of misconduct would involve no forfeiture but the second may impose forfeiture of an amount equal to the loss directly suffered by the employer in consequences of the misconduct and the third entail forfeiture of the gratuity that is due to the employee.”

The concept underlying this provision in the Act is that misconduct on the part of an employee should entail consequence either by way of reduction of the gratuity payment or by its total forfeiture. There are degrees and grades of misconduct and forfeiture of gratuity should arise only in the case of misconduct which may be described as grave or serious. There should be some deterrent against this class of misconduct.

Determination of the Amount of Gratuity [S.7]

An employee who is entitled for the payment of gratuity under this Act or any person authorised in writing to act on his behalf shall send a written application to the employer, within such time and in such form as may be prescribed, for such gratuity.

The employer shall determine the amount of gratuity and give notice in writing to the person to whom the gratuity is payable and also to the controlling authority specifying the amount of gratuity so determined.

In the case of a dispute with regard to the amount of gratuity payable to an employee or as to the admissibility of any claim or for payment of gratuity or as to the person entitled to receive the gratuity, the employer shall deposit with the controlling authority such amount as he admits to be payable by him as gratuity. The

⁷ 1969, II L.L.J. p. 755 (757)

employees will also have the right to make an application to the controlling authority for appropriate action.

Recovering of Gratuity

S. 8 of the Act provides that in case of default in payment of gratuity it will be recoverable as excess of land revenue together with compound interest at the rate of 9 per cent per annum from the employer.

Penalties [S. 9]

Where an employer fails to pay gratuity to an employee, he will be punishable with imprisonment for a term which may extend to six months or with fine which may extend to Rs 1,000 or both. Similar punishment is awarded in case of contravention or making default in complying with any of the provisions of this Act or any rules or order made thereunder.

In case of an offence relating to non-payment of any gratuity, punishment with imprisonment will not be less than 3 months, unless the Court trying the offence, for reasons to be recorded in writing, is of the opinion that a lesser term of imprisonment or the imposition of fine would meet the ends of justice.

Conclusion

This Act is an attempt to implement the Constitutional directive contained in Act 41 of the Constitution of India. Thus now it has become a statutory service condition. Workers are entitled to it irrespective of the financial position of the industries. Unlike bonus, which is also a statutory condition of service, the quantum of gratuity is not dependent upon the contingency of the size of the profit. The latter is more assured and certainly beneficial.

EMPLOYEES' STATE INSURANCE SCHEME

AN ALL INDIA health insurance scheme for industrial workers had been under the consideration of the Government of India for a long time as it was felt that provision should be made to safeguard workers against the fear of economic insecurity and to provide against interruption of incomes due to sickness, disablement, maternity, old age, unemployment, etc. In these contingencies, workers and their families often had to face serious hardships which reduced them to starvation level. In economically advanced countries provisions had been made for such risks through Social Insurance Schemes made compulsory for specified groups of persons by national law, the cost being generally met by employees, employers and the State. India also made a beginning in this connection by enacting the Employees' State Insurance Act, 1948, which provides for certain benefits in case of sickness, maternity and employment injury to workers employed in factories (including factories belonging to the Government) other than seasonal factories.

The Employees' State Insurance Act, 1948, applies to the whole of India except the State of Jammu and Kashmir.

“Factory” means—

“any premises including precincts thereof whereon twenty or more persons are working or were working on any day of the preceding 12 months, and in any part of which a manufacturing process is being carried on with the aid of power or is ordinarily carried on but does not include a mine subject to the operation of the Indian Mines Act, 1923, or a railway running shed.” [S.2 (12)].

“Seasonal factory” means a factory which is exclusively engaged in one or more of the following manufacturing process, namely cotton ginning, cotton or jute pressing, decortication of groundnuts, the manufacture of coffee, indigo, lac, rubber, sugar (including gur) or tea or any manufacturing process which is incidental to or connected with any of the aforesaid process. The expressions *“manufacturing process and power”* have the same meanings as in the Factories Act, 1948 [S. 2(12)].

“Employment injury” means a personal injury to an employee caused by accident or an occupational disease arising out of and in the course of his employment in a factory or establishment to which this Act applies, which injury or occupational disease would entitle such employee to compensation under the Workmen's Compensation Act, 1923 if he were a workman within the meaning of the said Act [S. 2(8)].

“Appropriate Government” means in respect of establishments under the control of the Central Government or a railway administration or a major port or a mine or oilfield, the Central Government and in all other cases, the State Government [S. 2 (1)].

Compulsory Insurance—Insurance under the Act is made compulsory in the case of all employees in factories or establishments to which the Act applies [S. 38]. The term *employee* as defined in section 2 (9) does not include any member of the Indian naval, military or air forces or any person employed on a remuneration which in the aggregate exceeds Rs 1,000 a month.

Contribution—The funds for the Scheme are to be derived from contribution payable by the employer and employee under the Act and from grants to be made by the Central and State Governments. The rates of the “employer's contribution” and the “employee's contribution” depend on the average daily wages of the employee for which purpose the employees have been divided into wage groups and contributions per week are payable as given in the following table.

TABLE SHOWING CONTRIBUTIONS

Group of Employees whose average daily wages are	Employees Weekly Contribution	Employer's Weekly Contribution	Total Weekly Contribution	Corresponding Weekly daily standard benefit rate
1	2	3	4	5
	paise	paise	paise	paise
1. Below Rs 2/-	Nil	75	75	130
2. Rs 2/- and above but below Rs 3/-	40	80	120	120
3. Rs 3/- and above but below Rs 4/-	50	100	150	175
4. Rs 4/- and above but below Rs 6/-	70	140	210	250
5. Rs 6/- and above but below Rs 8/-	95	190	285	350
6. Rs 8/- and above but below Rs 12/-	125	250	375	500
7. Rs 12/- and above but below Rs 16/-	175	350	525	700
8. Rs 16/- and above but below Rs 24/-	275	550	825	1,000
9. Rs 24/- and above	375	750	1,125	1,500

In the first instance, the principal employer shall pay both the employer's and employee's contribution in respect of every employee employed by him either directly or through another. The employer shall be entitled to recover from an employee directly employed by him the employee's contribution only by deduction from his wages. The employer shall bear the expenses of remitting the contributions to the corporation. The principal employer can recover the contribution paid by him on behalf of an employee employed by or through an immediate employer by deduction from any amount payable to him by the principal employer or as a debt payable by the immediate employer. The immediate employer shall be entitled to recover the employee's contribution only by deduction from the wages.

No employee's contribution shall be payable by or on behalf of an employee whose average daily wages are below Rs 2. Secondly for a week where no services are rendered by the employee except on the grounds of authorised leave or lock out or legal strike, no contribution is payable.

Employers—principal and immediate—must submit to the corporation or its officer returns as in the form and manner prescribed by the regulations, relating to persons employed by him or in respect of any factory or establishment of which he is either principal or immediate employer. They are to maintain registers and records, as prescribed by the regulations.

The Act makes provision for the *following benefits*—

- (a) *Sickness Benefit, i.e.,* periodical payments to any insured person in case of his sickness certified by a duly appointed medical practitioner.
- (b) *Maternity Benefit, i.e.* periodical payments in case of confinement to an insured woman, certified to be eligible for such payment by an authority specified by the regulations.
- (c) *Disablement Benefit, i.e.* periodical payments to an insured person suffering from disablement as a result of injury sustained as an employee under this Act and certified to be eligible by person authorized under the regulations.
- (d) *Dependent's Benefit, i.e.* periodical payments to such dependents of an insured person who dies as a result of an employment injury, as are entitled to compensation under the Act.
- (e) *Medical Benefit, i.e.,* medical treatment for and attendance on insured persons.

Besides the above contributions, the Act provides for a grant by the Central Government to the Corporation of 2/3rd of the cost administrative expenses during the first year and the State Governments are required to contribute about 1/3rd of the cost of medical care. The administration of the Scheme is to be entrusted to the *Employees' State Insurance Corporation* established by the Central Government under the Act and including representatives of employers and employees. All contributions under the Act and all other moneys received on behalf of the Corporation must be paid into a fund called the *Employees' State Insurance Fund* to be administered by the Corporation for the purpose of this Act. The Act also provides for the framing of Budget Estimates, the keeping of accounts and for the audit of such accounts of the Corporation. In connection with payment of contribution, the employer has to pay the amounts of his as well as the employee's contribution and then recover the employee's contribution by a deduction from his wages.

In considering the scope and effect of section 73, the Supreme Court held in *Backingham and Carnatic Co. Ltd. v. Venkatarayya*¹ that this section prohibits the employer from taking action by way of punishment against the insured employee during the period of his illness, whatever be the nature of his misconduct, but it has no application to such action taken after the illness period is over, or to an order of discharge which is the straight result of a standing order and is not by way of punishment.

The Act also provides for the establishment of *Employees' Insurance Courts* for determination of disputes arising under the Act, reference to High Court of questions of law appeals to the High Court from an order of an Employees' Insurance Court if it involves a substantial question of law. The Central Government has also framed rules entitled the Employees' State Insurance (Central) Rules, 1950, and the Employees' State Insurance (General) Regulation, 1950.

The Collection of Statistics Act 1953

This is a Central Act. It has been enacted with a view to facilitate the collection of statistics in the industrial and commercial world. The Act empowers the appropriate government to direct collection of statistics on matters relating to an industry or class of industries. Such a direction may also be in respect of any industrial or commercial concern or class of such concerns including factories. Further this could also be in regard to matters so far as they relate to conditions of work and welfare of labour in the following amongst other spheres namely living conditions, working conditions, labour disputes, labour turnover, trade unions, price of commodities, wages and attendance. The provisions of the Act come into operation once the direction is issued. Collection of statistics on matters falling under the central list in the Constitution cannot be carried on by a state. Similarly when a State government has issued a direction which is in operation, the Central Government shall not issue a directive on the same matter before the first one gets completed.

The Act makes provision for appointment by the appropriate Government an officer charged with responsibility of collection of statistics. Such an authority constituted by the appropriate government has the power to require an owner of an industrial or commer-

¹ 663, L.L.J. 638.

cial concern to furnish him or his authorized nominee the particulars required in such form as he may prescribe. He or his nominee has also the power to inspect the books and records of the owner. But information gathered shall not be published in a manner enabling people to identify the details with the owner except with the consent of the owner. Refusal to furnish the required information as well as improper disclosure of collected information are made penal by the Act. Power is vested in the Central Government to issue directions to the state government for executing the provisions of the Act. The appropriate government may also make rules to carry into effect the provisions and purposes of the Act.

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Preface to the Twentieth Edition

This edition has been thoroughly revised and adapted to the syllabus requirements of various Universities and Professional Examinations. It is divided into three parts, *viz.*,

Part 1 — The Indian Contract Act

Part 2 — Partnership; Sale of Goods; Negotiable Instruments; Insurance — Life, Fire & Marine; Common Carriers; Mortgages and Charges; Insolvency Law; Arbitration; Trade Marks and Patents

Part 3 — Industrial Law

Latest amendments to the various Acts and relevant case laws have been embodied.

Four other separate volumes are also published simultaneously to suit the needs of students appearing for examinations conducted by various examining bodies. They are: (i) "Business Law" for B.Com., of Bombay University; (ii) "Commercial Law" for B.Com., of Madras, Bangalore and Mysore Universities; (iii) "Mercantile Law and Company Law" for I.C.W.A., students and (iv) "Mercantile Law" for C.A.I.I.B. and ~~D.Com. (I.M.C)~~ professional courses.

In order to help the students to learn effectively and as an aid to memory, important points have been emphasized in bold or in italic letters; there is a summary at the end of each chapter followed by typical examination questions and a detailed index of case law and text for ready reference.

Davar's College of Commerce

Bombay

January 5, 1981

KHORSHED D.P. MADON

Preface to the Eleventh Edition

The Eleventh Edition has also been revised as usual with a view to meet the requirements of the Syllabuses of Professional and University Examination as suggested by Examination papers and revised syllabuses. The Indian Insurance Act, 1938, has been dealt with in great detail. Common Carriers Law including Carriage by Land, Sea and Air has been dealt with in a separate chapter entitled "Common Carriers and Carriage of Goods by Land and Sea". The New Indian Arbitration Act of 1940 replaces the old; the Provincial Insolvency Act also forms part of the Chapter on "Insolvency Law", and a separate chapter deals with "Trade Mark, Designs, Patents and Copyrights". Industrial Law Chapter also includes Payment of Wages Act of 1936. The Stamp Law and the Law of Limitation have also been brought up-to-date.

The author takes this opportunity to thank the professors and teachers of the subject once again, for their kind appreciation of the utility of this little book and expresses his gratitude for the many useful suggestions received from them. The author also trusts that the same encouragement will continue from his colleagues in the professional line.

The author's thanks are also due to his daughter, Miss Khorshed S. Davar, LLB., Advocate (O.S.) and Finalist of the Chartered Institute of Secretaries (London), for assistance in the revision of this Edition and to his son, Rustom S. Davar, A.C.C.S. (London), for preparing the index.

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SOHRAB S. DAVAR

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